Sustaining Trade and Exchange Rate Reform in Africa: Lessons for Macroeconomic Management

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Abstract

This chapter attempts to understand why trade and exchange rate reforms are reversed and the implications for macroeconomic management. It examines the mechanisms through which the reversals occur and the steps that might be taken to ensure that policy reforms, once taken, do not unravel.

Mechanisms for *sustaining* economic reform typically involve a combination of enhancing the rewards of constructive changes and increasing the penalties for delay. Over the last two decades, the judgement of economic performance has been assumed by donor agencies. They have sought to reward good performance through the provision of additional foreign aid and to ensure compliance by attaching conditions to their aid.

The performance of African countries casts doubt on the wisdom of this approach. Billions of dollars of foreign assistance and literally thousands of conditions have not produced sustained economic reform. Moreover, they have not left African countries better placed to move forward. This chapter maintains that the focus needs to shift from rewards and conditions to economic performance based on government self-restraint. Furthermore, for any government, a key feature of self-restraint is that policy reforms, once implemented, are not reversed.

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1. Introduction

For many years, countries in sub-Saharan Africa (hereafter Africa) maintained fixed exchange rates and trade restrictions designed to support the expansion of local industries. This strategy of import-substituting industrialization has led African countries into their current dire economic straits. In the aftermath of the various shocks – food, oil, debt – a major effort has been made to liberalize trade and rationalize exchange rate management. The intention is to raise economic efficiency by enhancing international competitiveness.

Trade liberalization has focused on reducing trade barriers, such as tariffs, quotas, or cumbersome customs procedures, and improving physical infrastructure. Exchange rate reform has involved a greater reliance on market mechanisms for exchange rate determination, more flexible management of external reserves, and programs to reschedule or write-off external debt.[1]
In broad terms, the results have been positive. Exchange rate distortions have diminished, tariffs have fallen, currency substitution and capital flight have eased, export growth has increased, the balance of payments has improved, and debt profiles have lengthened (*African Development Indicators, 1998-99)*.[2] Yet, in many African countries, the potential impact of these changes has been undermined by policy reversals (World Bank 1994; Dean, Desai and Reidel 1994; Rodrik 1998; Ancharaz 1998). The reversals have occurred directly, by changing trade and exchange rate policies. They have also been indirect through changes elsewhere in the economy. Examples include the introduction of non-tariff barriers such as quality standards and restrictions on landholding by foreigners. These impediments undercut the original goals of trade and exchange rate reform. There are many explanations for the reversals – economic, game-theoretic, political, and institutional. Little agreement exists on how they might be prevented.

This chapter attempts to understand why trade and exchange rate reforms are reversed and the implications for macroeconomic management. It examines the mechanisms through which the reversals occur and the steps that might be taken to ensure that policy reforms, once taken, do not unravel.

Section 2 explains the problem. Section 3 examines some of the important macroeconomic channels by which trade and exchange reforms are reversed. Section 4 suggests a number of approaches to deal with policy reversals. Section 5 has concluding comments. Three annexes expand on points in the text. Based on data from Ethiopia, Annex A illustrates how policy reversals become inevitable, in effect pre-programmed, when governments agree to an excessive number of donor conditions. Annex B examines the pressures on the real exchange rate in the franc zone. Annex C discusses the sequencing of economic reforms, particularly as they relate to trade liberalization and exchange rate reforms.

2. Policy Reversals – The Background

Many dimensions of Africa's poor economic performance over the last three decades have been widely discussed.[3] The literature shows that, with few exceptions, extensive economic regression has occurred. In the process, many African countries have become "wards of the international community" (Krugman 1989:184). External imbalances have been common and acute in all poorly performing countries. This is reflected in large balance of payments deficits, seriously overvalued real exchange rates, and insupportable levels of external debt.

a. External Imbalances in Africa

Several features of the external imbalances are shown in Tables 1 and 2 where, for convenience, we treat Africa as a single entity. This is not stretching the point. By world standards, Africa is a small economy. The most recent data show that its output and exports were around 1.5 percent of the respective world totals. Twenty countries (and even some states in the United States) have a larger economic product than the sum total of Africa.

The data clearly show the extent to which Africa has become marginalized within the world system of trade and exchange. Table 1 reports per capita income growth for Africa and the world, real GDP, exports of goods and services, imports of goods and services, and “trade” (the sum of imports and exports). The table also gives Africa’s share in world totals of output, exports, imports, and trade. Since 1981, the growth of real income in Africa has lagged the world growth rate. Until the mid-1980s, Africa’s income was roughly 1.6 percent of the world total. In the early 1990s, it was 1.3 percent. There was some improvement in 1995 and 1996, but recent evidence shows that that trend has been short-lived.

In 1970, Africa had 6 percent of the world’s population. By 1996, that share was around 10 percent. These trends of falling income share and rising population share have sharply intensified Africa’s relative (and absolute) poverty.

Many factors have contributed to these circumstances. One has been the lack of dynamism in trade. Over the period 1970 to 1997, the dollar value of Africa’s exports rose by 106 percent. Due to rising debt and the lack of foreign exchange, the value of imports increased over the same period by only 93 percent. By contrast, world exports and imports increased by a factor of four. Yet, even with the substantial implied loss of trade share (which fell by more than half) Africa continues to be more heavily dependent on trade than the rest of the world (Rodrik 1998; *World Development Indicators 1999*).

There are a number of explanations for this phenomenon. With few exceptions (Botswana and Mauritius), African countries sought to achieve rapid economic growth by restricting trade. This *voluntary* compression of trade was the result of explicit policy choice. While many countries in other regions were adopting policies that would increase the dynamism of external sectors, African policy makers took measures to insulate themselves from the world’s trading system. The tragedy (in terms of declining income and welfare) is that most of them succeeded. In doing so, the countries acquired a policy-induced comparative *dis*advantage in trade that undermined growth and development.

One of the major policy-related factors that reduced the growth of trade throughout Africa has been a persistent and often massively overvalued real exchange rate (Lopez and Thomas 1988; Edwards 1989; Caballero and Corbo 1989; Pinto 1990; Dollar 1992; Ghura and Grennes 1993; Rouis, Razzak, and Mollinedo 1994; Duesenberry *et al.* 1996; Ghura and Hadjimichael 1996;

Table 1. Sub-Saharan Africa and the World: GDP, Exports, Imports and Trade, 1970 to 1997

Year	GDP, market prices (billion 1987 USD)			GDP p.c. growth (annual percent)		Exports of Goods and NF Serv. (billion 1987 USD)			Imports of Goods and NF Serv. (billion 1987 USD)			Trade * (percent of GDP)		Population growth (annual percent)	
	Africa	World	Percent	Africa	World	Africa	World	Percent	Africa	World	Percent	Africa	World	Africa	World
1970	151.5	7195.1	2.1	2.8	0.5	48.7	1295.5	3.8	49.4	1338.9	3.7	46.0	28.0	2.7	2.1
1971	161.8	8388.9	1.9	2.5	1.8	50.1	1377.2	3.6	53.4	1407.3	3.8	45.6	27.2	2.6	2.1
1972	165.0	8701.7	1.9	0.7	2.6	52.8	1494.7	3.5	48.9	1521.1	3.2	45.3	27.3	2.6	2.1
1973	170.8	8577.0	2.0	1.3	3.2	52.5	1648.8	3.2	53.2	1708.6	3.1	46.9	30.0	2.7	2.0
1974	184.1	8047.5	2.3	2.9	0.7	51.6	1746.2	3.0	62.0	1774.8	3.5	54.7	36.4	2.7	2.0
1975	188.1	8346.7	2.3	0.8	0.6	50.1	1707.8	2.9	65.3	1664.9	3.9	53.8	33.9	2.8	1.9
1976	198.1	8761.0	2.3	1.9	2.8	52.6	1868.3	2.8	64.6	1840.1	3.5	53.9	34.9	2.8	1.8
1977	203.5	9212.4	2.2	0.9	2.2	57.2	1978.1	2.9	71.5	1941.7	3.7	54.5	34.9	2.9	1.8
1978	206.7	9821.1	2.1	0.5	2.4	56.4	2092.8	2.7	72.5	2038.1	3.6	53.9	34.0	2.9	1.7
1979	212.5	9710.6	2.2	0.9	2.1	60.9	2246.6	2.7	68.7	2201.1	3.1	54.8	36.4	3.0	1.8
1980	223.8	9049.2	2.5	0.5	0.7	63.9	2344.0	2.7	81.6	2250.2	3.6	59.5	38.8	3.1	1.7
1981	224.7	9653.6	2.3	-0.1	0.8	56.7	2425.5	2.3	88.4	2291.4	3.9	56.6	38.7	3.0	1.7
1982	227.4	10381.1	2.2	-1.9	0.2	54.6	2395.8	2.3	76.3	2239.8	3.4	51.8	37.0	3.0	1.8
1983	224.6	11147.1	2.0	-4.4	1.6	53.6	2475.5	2.2	67.5	2291.6	2.9	47.8	36.3	3.1	1.8
1984	228.7	12989.6	1.8	-1.7	2.5	58.3	2705.6	2.2	69.2	2535.8	2.7	49.7	37.9	3.5	1.7
1985	230.6	14815.0	1.6	-2.0	1.9	61.8	2804.3	2.2	65.9	2648.5	2.5	51.0	37.1	2.9	1.7
1986	236.4	16326.7	1.4	-0.4	1.7	61.6	2902.7	2.1	61.6	2771.1	2.2	49.5	34.1	2.9	1.8
1987	241.3	16095.9	1.5	-0.9	2.0	61.1	3095.9	2.0	59.9	2980.3	2.0	50.5	34.7	2.9	1.8
1988	257.7	18734.3	1.4	0.6	2.5	65.5	3363.2	1.9	66.7	3264.4	2.0	49.5	35.7	2.9	1.8
1989	265.4	20163.6	1.3	0.5	2.0	70.0	3613.1	1.9	68.3	3516.1	1.9	51.8	37.1	2.9	1.7
1990	268.9	20475.0	1.3	-1.9	1.3	72.4	3830.2	1.9	68.1	3695.2	1.8	53.2	37.9	2.9	1.7
1991	272.1	21523.9	1.3	-2.0	0.5	71.9	4020.8	1.8	69.5	3804.2	1.8	52.0	38.3	2.7	1.6
1992	269.1	22362.0	1.2	-2.9	1.1	75.5	4278.5	1.8	74.8	4041.1	1.9	54.7	40.8	2.9	1.6
1993	270.7	24372.8	1.1	-1.0	1.1	76.1	4498.8	1.7	74.3	4225.1	1.8	55.1	39.9	2.3	1.5
1994	275.3	26779.7	1.0	-0.5	2.0	80.0	4924.5	1.6	78.6	4643.3	1.7	57.3	41.0	2.7	1.5
1995	286.7	27518.6	1.0	1.0	1.9	86.6	5396.5	1.6	87.2	5082.3	1.7	56.1	42.5	2.8	1.5
1996	301.2	28215.8	1.1	1.8	2.2	96.0	6398.3	1.5	93.3	5381.4	1.7	56.2	43.0	2.8	1.4
1997	311.8	28345.5	1.1	0.5	2.1	101.9	6792.9	1.5	101.9	6491.3	1.6	64.0	42.0	2.7	1.1

*Note: * Trade is defined as Exports plus Imports*

Source: World Development Indicators, 1999, World Bank

African Development Indicators,1998/99, World Bank

Table 2. Sub-Saharan Africa: Basic Macroeconomic Indicators, 1970 and 1980 to 1998

Macroeconomic Indicators	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
GDP (bill. USD, 1995 prices)	251.6	263.2	261.5	256.7	266.4	264.8	269.6	275.8	287.4	295.7	298.5	300.0	296.1	298.5	305.3	317.7	332.7	344.0	350.7
GDP growth (annual %)	5.7	4.6	-0.7	-1.8	3.8	-0.6	1.8	2.3	4.2	2.9	0.9	0.5	-1.3	0.8	2.3	4.1	4.7	3.4	1.9
GDP growth per capita (annual %)	2.6	1.7	-3.6	-4.9	0.9	-3.5	-1.1	-0.6	1.3	0.0	-2.0	-2.4	-4.2	-1.4	-0.2	1.3	1.9	0.6	-0.7
Agriculture as share of GDP (annual %)	17.9	19.5	20.2	18.6	19.3	22.1	21.9	20.6	21.7	20.2	19.1	19.1	17.6	17.8	16.7	16.6	17.6	17.9	18.3
Manufacturing as share of GDP (annual %)	12.0	13.1	12.9	13.4	13.1	12.1	12.7	13.2	14.0	14.0	14.5	14.5	14.4	14.2	13.8	14.0	12.9	12.7	11.9
Services as share of GDP (annual %)	37.2	39.0	39.6	40.8	41.0	39.4	40.8	41.2	41.6	41.2	43.3	44.4	46.1	46.8	47.0	48.0	46.7	46.8	47.7
Gross Domestic Investment (% of GDP)	20.2	22.8	19.8	16.2	15.5	13.8	14.6	14.6	16.5	15.8	14.2	17.0	14.7	16.2	17.5	18.5	17.7	17.4	17.8
Gross Domestic Savings (% of GDP)	28.5	23.2	21.1	20.5	21.0	21.2	20.9	20.5	19.2	19.4	17.9	18.2	13.0	14.5	16.5	16.2	17.7	16.4	14.8
Export of Goods & NF Services (% of GDP)	30.6	25.5	23.3	22.4	24.0	25.0	24.0	24.1	24.0	25.0	26.5	24.7	25.8	25.1	27.6	28.8	30.9	29.8	27.2
Import of Goods & NF Services (% of GDP)	27.7	30.7	27.8	23.8	24.1	23.2	23.4	23.7	24.3	24.5	24.5	24.4	26.9	26.6	28.7	30.5	30.4	30.8	30.6
CA,excl. Net Off.Cap.Grants (Net, bill.USD)	-4.1	-16.1	-16.9	-12.0	-6.8	-3.2	-8.2	-7.2	-12.0	-7.7	-8.1	-11.1	-13.5	-13.2	-11.5	-14.7	-7.4	-9.9	*-15.3*
Inflation, Consumer Prices (annual %)	9.4	11.2	17.0	16.1	11.2	6.5	10.2	8.2	10.4	9.0	13.1	13.8	18.8	9.2	13.4	9.8	9.4	10.1	..
Imports of Food (% of GDP)	..	..	..	..	1.2	2.7	2.4	1.8	1.8	1.7	1.7	1.7	1.7	1.8	2.0	2.4	2.3	2.3	2.4
Food Production Index (1989-91=100)	77.7	80.8	81.3	79.8	79.5	85.3	89.8	88.6	94.7	97.6	98.6	103.8	103.8	108.1	111.8	112.9	117.9	117.9	..
Food Production Index p.c. (1989=100)	105.3	108.5	107.1	101.6	98.3	100.2	103.4	100.2	100.9	101.1	99.5	99.1	96.0	96.3	94.6	96.8	95.2	93.6	..
Food Aid (in cereals, mill. metric tons)	2.2	2.2	2.2	2.6	4.1	3.1	2.8	2.9	2.2	2.1	2.4	3.4	5.9	3.3	3.0	..	..	..	..
Population growth (annual %)	3.1	2.9	3.0	3.1	2.8	2.9	2.9	2.9	2.9	2.9	3.0	2.9	2.9	2.2	2.5	2.7	2.8	2.8	2.6
Foreign Direct Investment (Net, bill. USD)	-0.7	0.2	1.7	1.1	1.3	0.8	1.5	1.6	1.5	3.6	0.8	1.7	-0.4	1.0	1.1	1.4	3.6	5.5	3.64
External Debt, total (bill. USD)	84.1	93.1	96.8	108.8	109.9	123.6	139.7	148.0	150.5	157.4	177.4	183.9	183.1	195.3	216.5	230.6	227.1	219.3	181.7
External Debt, total (% of GDP)	22.9	26.4	31.5	37.1	41.4	54.2	56.2	58.6	56.9	58.3	59.7	60.6	60.0	65.5	78.1	73.6	69.5	63.6	54.5
Net ODA, all donors (bill. USD)	7.4	7.3	7.5	7.3	7.6	8.5	10.5	12.1	13.7	14.5	17.3	17.0	18.3	16.8	18.2	17.9	15.7	14.2	..
Net ODA, all donors (% of recipient's GDP)	2.5	2.5	2.8	2.9	3.3	4.1	4.6	4.8	5.2	5.4	5.8	5.6	5.8	5.5	6.3	5.6	4.7	4.1	..

Sources: African Development Indicators, 2000, World Bank

World Development Indicators, 1999, World Bank

Yeats *et al.* 1996, 1997; Collier and Gunning 1999; Luvunga and Bol 1999). Table 2 shows the major macroeconomic trends. African countries have had persistently large balance of payments deficits. Their external debt cannot be serviced without extraordinary, extended, international support. Real income growth has been low. Indeed, in per capita terms, real income has declined. African countries have become acutely aid dependent. Aid flows have risen relative to GDP without any tangible evidence that income growth has increased on a sustained basis. Finally, the compression of imports is further confirmation that the overvaluation of the real exchange rate has led to acute shortages of foreign exchange and eroded Africa's international creditworthiness.

b. Policy Reversals

Understanding the types of policy changes that are needed to promote trade and exchange rate reform is one thing; sustaining them is another. Every remedy for Africa's economic difficulties has emphasized removing restrictions on trade and realigning the foreign exchange rate. Most African governments have been slow to make these changes.[4] They have regularly compounded the difficulties by allowing the reforms to unravel. Furthermore, they have also failed to sustain policy changes that indirectly support trade and exchange rate reform. Some backsliding has resulted from misfortune. The Gulf War erupted as several countries began to implement reforms. And, for some countries, drought has undermined anticipated local responses to policy changes. Most policy reversals, however, have been intentional.

Of the African countries that are not embroiled in war or civil strife, almost all are now well into their second decade of attempting to promote economic reform. Billions of dollars of donor support have been provided with no tangible evidence that any country (apart from Mauritius) has sustained their reform effort. Two examples illustrate the point. The first is Zambia. Following its democratic reforms in 1991, Zambia received large amounts of foreign assistance – more than $7.9 billion between 1991 and 1998 (Fernholz 1999).[5] However, from mid-1995 onwards Zambia began to reverse a number of its reforms and defer implementation of earlier commitments. Both trade and exchange rate reforms were affected. The principal outcome is that poverty in Zambia has intensified.[6] The second case is Ghana. It began implementing a comprehensive reform program in 1983. Major improvements were made for several years (Younger 1989; Stryker 1991; IMF 1995, 1999). Progress came to a halt in 1991 and 1992 when inflation accelerated. Since then the government has failed to vigorously promote reform despite its highly publicized commitment to making Ghana a middle-income country by 2020.[7]

These two examples are not exceptional. Most African countries have adopted economic reform and then deflected or abandoned many of the main elements. Why has this happened? Why have policy makers, all of whom understand the national benefits of policy reform, allowed (and frequently encouraged) economic reform to unravel?[8]

There are a number of explanations. Recurring themes are: difficulties of promoting policy change, gamesmanship, and inconsistencies in the policy agenda.

The Dilemma of Policy Change: Policy makers often have difficulty supporting change. Change creates uncertainty. It gives the impression (whether deserved or not) that they have lost control.

Moreover, whatever the outcome induced by the change, some group will be dissatisfied.[9] If the new policy works as intended, those benefiting from the *status quo* lose. If it does not have the intended effects, those who expected to gain will be disappointed and the groups whose benefits were threatened will be resentful.[10]

Policy makers often have a personal interest in preserving the *status quo*. They, or their associates, directly benefit from current conditions. Policy change may also be resisted for pragmatic reasons. Policy makers sometimes make changes that later have to be reversed. This has frequently occurred with tariff reform. Reducing tariffs often lowers revenue that cannot be recouped from other sources, especially in the short run. The resulting revenue gap creates difficulties with donor agencies such as the International Monetary Fund (IMF). As a demonstration to the Fund of its commitment to reform, governments then have to raise tariffs.[11] Such behavior creates serious problems even in rich countries.[12]

The Policy Agenda: With few exceptions, the IMF and World Bank determine the reform agenda in Africa. Since most African countries have chronic external and internal imbalances, Fund/Bank programs have many elements in common. Some critics argue the programs are too ambitious (Dell 1984; Lal 1987; Killick 1987; enda 1990; Schatz 1994; van de Walle 1994; van Drunen and van der Kraaj 1994; Sachs 1996; Lensink 1996; HIID 1997). Others, including the writer, believe that important changes, especially in the area of exchange rate realignment and the removal of barriers to trade, are not implemented fast enough. On both counts, the programs are flawed. Annex A describes aspects of the Fund/Bank program in Ethiopia. Some measures cannot be implemented in the time frame specified; some are being implemented too slowly; and some are "stroke-of-the-pen" measures that have been needlessly dragged out. Yet, irrespective of how the measures are grouped, the overall program grossly exceeds the implementation capacity of the Government of Ethiopia. In this case, non-performance and policy reversals have been pre-programmed.

One defense of the Fund and Bank is that their staffs are simply responding to the difficulties they encounter in Africa. The economic distortions are so deeply embedded that comprehensive reform is seen as the only option. Their staffs have judged that prompt action across a broad front is essential to prevent further deterioration.

This approach has been severely criticized. For their part, African governments argue that the reform measures proposed by the Fund and Bank (privatization, civil service reform, market liberalization, devaluation, and improved governance) either do not work, or are not appropriate to their stage of development (ECA/OAU 1989; enda 1990). They also argue that the international community adds to the difficulties by failing to provide the resources needed to adequately ease the costs of adjustment and reduce the burden of foreign debt. Among development specialists, critics argue that the reforms being pushed by the Fund and Bank are not working.[13] As evidence, they cite the lack of progress across Africa despite massive Bank/Fund involvement. Moreover, even in the few cases where the situation has improved, the gains have been exceedingly modest (Killick 1987; enda 1990; Sandbrook 1993; Schatz 1994; van de Walle 1994).

Many of the World Bank's own assessments support this view (Commins 1989; Thomas *et al.* 1991; Gallagher 1991; World Bank 1994; Bouton, Jones and Kiguel 1994). An increasing number of commentators have argued that the (so-called) "Washington consensus" on economic reform has been wrong or, at best, misguided (Taylor 1997).[14]

One factor that complicates the situation is that the Bank and Fund, like all bureaucracies, are subject to interest group pressure. Unable or unwilling to resist these pressures, their staffs continue to add to the range of conditions they require of African countries. The outcome has been to reconfirm, on an Africa-wide basis, the *carte blanche principle* (Leibenstein 1980). In theory, conditions attached to programs are meant to raise the probability that the agreed reforms will be implemented. When monitoring costs are low, donor agencies have an incentive to add conditions. Typically, the costs of compliance are ignored. Under these circumstances, conditions detract from, rather than enhance, economic performance. Again, non-performance and policy reversals are pre-programmed.

Games: In *The Strategy of Conflict*, Thomas Schelling (1960) noted that complexity allows goals to be deflected. He also observed that perceived weakness is often a source of strength. African policy makers are aware of these notions and apply them successfully in their various "games" with members of the international community (van de Walle 1996; Fernholz *et al.* 1996; Berg 1996; European Union 1996; Mellor 1998).

Given the scope and complexity of the policy agendas promoted by the IMF and the World Bank, it is relatively easy for African policy makers to deflect reform. It has also been easy for them to co-opt the staffs (and Boards) of both organizations. Despite the apparent stringency of the conditions attached to their aid, both the Fund and the Bank have gone to extraordinary lengths to ensure that their programs do not appear to have failed. Recognizing this, African policy makers have become adept at making the case for taking more time to deal with their country's economic imbalances.[15] In practical terms, this extends the time African countries take to reduce their budget deficits, sell off state-owned enterprises, restructure their civil services, and so on. Such delays are possible because Fund and Bank programs are the principal means by which African governments gain access to the financing and debt relief (from bilateral donors, the Paris Club, and the London Club) that allows adjustment to be postponed (Lewis and McPherson 1994). Less generous financing would compel faster adjustment or, in cases where governments remain opposed to adjustment, accelerate economic collapse.

In skilled hands, the whole process can be dragged out for years. (Policy makers in Senegal and Kenya have been two of the best at this.) One implication is that African policy makers generally expect to under-perform. More important, however, is that so long as under-performance does not threaten the flow of donor support, the incentives for policy makers to change are outweighed by the incentives to delay reform.

A further aspect of "gamesmanship" has arisen in the context of donors insisting that African governments take ownership of economic reform.[16] African governments will convey the impression that they are taking the initiative in promoting reform in return for Fund and Bank staff indulgence with respect to the removal of specific controls. In this way, Bank/Fund programs typically allow the phased removal of major constraints such as exchange controls.[17] This stratagem has enabled African governments to retain restrictions that, if removed, would antagonize their key constituents. Such horse-trading is counter-productive since these particular reforms should not be delayed. In order to rationalize the system of trade and exchange, they are precisely the reforms that need to be accelerated.

Overview: Policy reform is driven by mixed motives. There is no guarantee that the changes to which governments agree will have the anticipated effects. Resistance to change among policy makers and resentment among those who lose out are understandable. Yet, policy makers who resist change over extended periods are being irresponsible. No economy can adapt in ways that support long-term growth and development unless there is broad-based change.

Since this chapter seeks to explain why reforms have been delayed and reversed, my hypothesis is that economic reform in Africa has *not* been pushed too rapidly. *Prima facie* evidence is that Africa has continued to decline despite two decades of structural adjustment and massive foreign assistance. Moreover, since most governments have only partially implemented the reforms to which they have agreed, it is premature to argue that the reforms do not (or will not) work.[18] The experience of The Gambia and Mauritius, which implemented comprehensive adjustment programs, shows that reforms can work *if* they are tried (McPherson and Radelet 1995; McPherson 1999).

A factor that retards reform and leads to policy reversals has been the games between African policy makers and donors. On most occasions, these games have adverse macroeconomic outcomes. African policy makers have been reluctant to reform. (The evidence is that very few policy makers have promoted economic reform without external pressure.) Donor agencies have been reluctant to allow economic deterioration to continue. (The evidence is donors perseverence in the face of repeated failure.) In the process, trade and exchange rate reforms have been undermined, compromising long-term growth and development.

3. The Policy Issues

Policy reforms occur directly and indirectly. In the case of trade and exchange rate reforms, the direct changes are familiar: tariffs are lowered, tax compliance is improved, special exemptions are withdrawn, customs procedures are streamlined, export taxes are eliminated, import licenses are abolished, exchange controls are lifted, and the nominal exchange rate is devalued. There is now a rich literature on all of these issues and graduate school courses regularly cover these topics.

The indirect paths to trade and exchange rate reforms are less obvious and not so readily taught or researched. Examples include the removal of restrictions on land holding that prevent foreigners from investing in export-oriented industries, the lifting of quality controls that maintain a local monopoly, or improved infrastructure that induces farmers to increase the output of raw materials for an export processing activity.[19] The government may decide to limit expenditure. This will curtail deficit financing that generates inflation and leads to an appreciation of the real exchange rate (especially when the nominal exchange rate adjusts slowly to price changes). The government may also take steps to stabilize and deepen the financial system thereby increasing the supply of finance and lowering the costs of working capital for potential exporters.

These examples (and more provided later) highlight changes in the structure of the economy, reflected in the *inter-industry flows* of goods and services, factor payments, taxes, and transfers that influence the macroeconomic setting in which trade and exchange reform occurs. The effects are familiar to analysts who trace policy changes using input-output tables or who derive impact and dynamic multipliers from simultaneous equation systems. Indeed, viewed in historical context, trade theorists were among the first to argue that a full assessment of the economic impact of specific policy changes (such as lower tariffs) requires an analysis of the whole structure of taxes, subsidies, and factor payments. The most obvious example of this point is the difference between nominal and effective rates of protection that emerges as the system of inter-industry relations "filters" the effects of *all* taxes, subsidies, and trade-related restrictions on factor payments throughout the economy (Corden 1966; Bruno 1972; Gillis *et al.*1996).

Highlighting the direct and indirect effects of policy change broadens our appreciation of the processes of policy reform *and* policy reversal. We recognize that trade and exchange rate reforms occur directly and indirectly in the ways outlined above. Just as important, however, is the fact that such reforms can be *undermined* directly and indirectly (IMF 1984).[20]

The following discussion focuses on some of the more important indirect influences on trade and exchange rate reform. Issues covered are the real exchange rate, macro-economic stability, agricultural development, capital accumulation, foreign direct investment, unit labor costs, physical infrastructure, option values and irreversibility, and aid dependence.

a. Real Exchange Rate

Policy makers can directly control the nominal exchange rate. Their influence over the real exchange rate is indirect and often tenuous. Movements in the real exchange rate depend on domestic and foreign inflation, changes in factor productivity, taxes, subsidies, non-price restrictions, and other elements that affect domestic resource costs. Taken together these changes determine whether devaluation of the nominal exchange rate translates into a *sustained* real devaluation. More important from the perspective of *sustained* policy reform, there are many channels through which the effects of a nominal devaluation aimed at producing a real devaluation can unravel.

A fundamental problem in most African countries has been persistent overvaluation of the real exchange rate. The data in Tables 1 and 2 illustrate the more common adverse outcomes: chronic balance of payments deficits, slow export growth, rising external debt, increasing aid dependence, and sluggish economic growth.

Since all of these negative effects can be traced to persistent real exchange rate over-valuation, it might be expected that African policy makers would pay close attention to the issue. In practice, they do not. This is evident from their public statements, the few policy memoranda that become public, and the policy decisions they take. This is puzzling. Policy makers in Africa (and elsewhere) have been repeatedly warned about the problems created by "Dutch Disease" (Roemer 1984; Gillet *et al.* 1996). They have also had to live with the extensive adverse effects of chronic real exchange rate over-valuation that are reflected in flourishing parallel markets for foreign exchange, capital flight, currency substitution, slow export growth, and declining per capita income. As pointed out in Annex B, the CFA franc was chronically overvalued and its adverse effects were evident for almost two decades before the respective francophone governments took steps to rectify the situation.

When policy makers have emphasized the exchange rate, their attention has invariably been stimulated by the political difficulties created by movements in the nominal exchange rate. A major concern has been stability of the nominal exchange rate. This preoccupation continues even though many governments have now formally removed exchange controls and floated their currencies. Unfortunately, most floating exchange rates across Africa are subject to considerable official management.[21] Since this pattern of "management" is heavily influenced by domestic political considerations, changes in local prices, international prices, unit labor costs, the costs of transport, or the overall structure of taxes and subsidies are typically not fully taken into account.[22] The outcome has been that real exchange rates have tended to remain over-valued, often acutely so.

The empirical evidence of the importance for economic growth and macroeconomic stability of a real exchange rate that is close to its fundamental equilibrium value is compelling.[23] Accordingly, policy makers who emphasize rapid growth pay close attention to policy reforms that prevent the chronic overvaluation of the real exchange rate. Such emphasis is evident in the developed countries among senior policy makers.[24] We need only recall the concern over exchange rate movements during the 1980s that culminated in attempts under the Plaza and Louvre Accords to reduce the real overvaluation of the dollar. Over recent years, and especially since the financial turmoil in Asia, the Secretary of the U.S. Treasury and his G-7 counterparts have regularly conferred about the impact of the movements of the dollar relative to other major currencies.

Such concern has been absent from the policy debate in African countries. Central bank governors and ministers of finance have tended to focus on debt relief and the need for continued aid flows.[25] But, perhaps the most important indicator has been the actions of government. When the nominal exchange rate is adjusted, few African governments have maintained the fiscal and monetary discipline needed to sustain the real devaluation (Quirk *et al*. 1987; Khan and Lizondo 1987; Reisen 1989; Goldbrough *et al.* 1996; Calamitsis *et al.* 1999).

b. Macroeconomic Stability

Fiscal discipline has been central to donor-supported adjustment programs because it has a direct role in achieving and sustaining macroeconomic stability. One of the clearest results of the empirical studies of African economic performance is that macroeconomic stability is fundamental to efforts to revive growth and development.[26] Without stability, private investment *does not* recover and incentives for promoting exports erode. This is not an issue which African governments can fudge. For sustained growth and development, macroeconomic stability has to be established *and* maintained. The matter is relevant to trade and exchange rate reforms, and macroeconomic stability provides a setting against which they, too, can be sustained.

Yet this is an area where African countries have performed poorly. Structural adjustment programs have invariably focused on reducing the imbalances that generate macroeconomic instability. As noted in section 2, critics of structural adjustment question the value of these programs. They note that there have been literally hundreds of such programs in Africa with most countries having had several. Critics argue that this fact alone demonstrates the programs are fundamentally flawed. If not, the programs would not need to be modified and re-calibrated so often. Proponents of structural adjustment, however, point out that few African governments have implemented the programs fully and expeditiously. In the cases where they have – The Gambia and Mauritius – the anticipated structural changes have occurred. This debate will undoubtedly continue.

In practical terms, however, broad-based policy reforms (even when imperfectly implemented) have helped a number of African economies achieve a degree of macroeconomic stability (United Nations 1996; AfDB 1997). Because of this, some observers have even suggested that Africa is "on the move" (Camdessus 1996; Madavo and Sarbib 1997; IMF 1997; Wolfehnson 1997; Botchwey 1998; Sweden, Government of 1998; Fisher *et al.*1998). If true, this would be a welcome break with past trends. At best, the evidence is mixed (McPherson and Goldsmith 1998). Recent editions of *IMF Outlook* (May 1999, Appendix Tables 5, 7) show that for a period during the mid-1990s, growth rates in many African countries increased and inflation declined. Yet, inflation in Africa remains substantially higher than in the advanced market economies. Moreover, since savings and investment rates have not increased and private capital flows remain small, the growth spurt of the mid-1990s cannot be sustained. Finally, resurgent strife and open warfare in several areas cloud Africa's prospects for achieving economic stability.[27] Thus, the prospects for soon achieving the macroeconomic stability that will allow trade and exchange rate reforms to be sustained remain highly uncertain.

c. Agricultural Development

African agriculture has some examples of successful development on a local basis, but the broader trends over recent decades have been adverse (Lele 1981; Eicher 1982; World Bank 1989:Ch.1; Eicher and Baker 1992; WINROCK 1993; Goldman 1994; Badiane and Delgado 1995; GCA 1999). This has been most evident in the overall reduction in food security (von Braun 1991; Abassa 1995; Bush 1996, *Agricultural Development Indicators* 1998/99) There are many reasons. Trade and aid in food and agricultural commodities have created many distortions. Public policies at both the macro and micro levels have generally overtaxed agriculture (Schiff and Valdes 1998; Barrett and Carter 1999). This overtaxation has undermined local production and placed agricultural exports at a major comparative disadvantage (Stryker and Baird 1990; Oyejide 1993). Finally, although African countries experience recurrent drought, African governments have rarely taken measures (through physical storage or financial arrangements) to compensate (Glantz 1989; Bensen and Clay 1998).

Reversing these trends requires actions that will make agriculture more dynamic. One option is domestic liberalization (Eicher 1982, 1992; Lele 1989).[28] Another is to promote agricultural exports. Having these propositions accepted by African policy makers has always been problematic. “Export pessimism”, based upon the Prebisch-Singer hypothesis, has dominated official thinking for much of the post-independence period. According to this hypothesis, the decline in the terms-of-trade for primary commodity producers was so prolonged, so pronounced, and so assured that developing countries could not expect to grow and develop on the basis of primary commodity production.[29]

African leaders were “export pessimists” from an early stage. Ghana’s Kwame Nkrumah and Tanzania’s Julius Nyerere, for example, became convinced that agriculture and primary product exports could not stimulate growth and development. To support his conviction, Nkrumah went to extraordinary lengths to industrialize Ghana. He also encouraged pan-African cooperation to expand industrial capacity and infrastructure so as to take advantage of economies of scale. For his part, Nyerere collectivized Tanzanian agriculture and focused on Mahanobis-inspired “boot-straps” approach to industrialization. Both efforts were meant to promote development.

At first, the flurry of activity involved in implementing these approaches gave the appearance that they were succeeding. Many other African leaders were impressed and began to believe that their countries could only develop if they did likewise. The result was the widespread use of import substitution during the 1960s and 1970s to achieve industrialization. Some experts objected to the way the strategy neglected agriculture but their views had little impact (Dumont 1966; Lipton 1977; Myint 1979; Dumont and Mottin 1980; Lele 1981; Eicher and Baker 1992). Recent cross-country empirical analysis has indicated that their objections were well-founded (Sachs and Warner 1997; Radelet, Sachs and Lee 1997). Moreover, some countries outside Africa, particularly Brazil, Malaysia, Indonesia and Thailand, made major gains by expanding their exports of primary commodities many of which were those whose production was declining in Africa.

More important, both Ghana and Tanzania failed dismally in their attempts to industrialize. The damage to both countries from their prolonged neglect of agriculture has been profound. Despite their huge potential, both countries remain among the poorest in the world, largely unable to provide their populations with rising standards of nutrition and food security (*African Development Indicators* 1998/99:Tables 5.36, 8.5; *World Development Indicators* 1998:Table 3.3).

As evidence of the failure of industrialization based on import substitution accumulated, attention shifted to liberalization strategies (Meier 1995, Pt.IX; Sachs 1996; Krueger 1997).

For inspiration, many African policy makers have turned (or been directed) to the example provided by the (so-called) "Asian miracle" (WINROCK 1993; World Bank 1993; Lindauer and Roemer 1994; Stiglitz 1996). Although the performance of some Asian countries has been tarnished by the financial collapse in 1997, African policy makers have tended to see Asia's success as resulting from government activism in stimulating manufactured exports. Missed in this assessment is that the Asian performance (even with the recent difficulties) reconfirms the long-standing historical result that the foundation for sustained growth in manufacturing was laid by a period of rapid expansion of agricultural output based on improvements in agricultural productivity.[30] Indeed, Asian experience has shown that the development challenge has never been whether to emphasize agriculture *or* industry. The challenge is to devise policies that encourage both sectors to grow in complementary ways (Mellor 1966, 1976, 1976a; Schuh and Barghouti 1988; Timmer 1989; Goldman 1994; Tomich, Kilby and Johnston 1995; Gillis *et al.* 1996).[31]

There is no doubt that primary commodity production involves some special problems, particularly the often sharp fluctuations in prices and drought-induced changes in output. African countries typically face the problems of being marginalized from world markets compounded by disadvantages of being tropical and land-locked (Sachs and Warner 1997; Bloom and Sachs 1998). Most important, Africa's agricultural problems are so deep-rooted that the continent as a whole is a chronic food deficit area. The deficit has the paradoxical effect of boosting agricultural income outside Africa. Properly managed, agriculture in Africa should be a major competitor on world grain and meat markets. Part of that proper management, however, will involve the implementation of trade and exchange rate reforms that remove the long-standing biases against agriculture.

d. Capital Accumulation

A number of analysts suggest that the prospect of economic reforms being reversed diminishes as the reforms succeed in creating a "supply response" (Haggard and Kaufman 1992; Krueger 1993; Sandbrook 1993; Sachs 1994; Brautigam 1996, 1997).[32] This can occur in several ways. For instance, following the liberalization of the exchange rate there may be a rapid improvement in the current account of the balance of payments or following a major tariff reduction (devaluation in another guise) export growth may accelerate. Vital to such a supply response, however, is the availability of under-utilized capital, or investors willing to expand their productive capacity (Rouis *et al.* 1994).[33]

These points reaffirm the importance of capital formation, especially human capital formation, in promoting growth and development. East Asia's success has been particularly noteworthy for the special role assumed by the respective governments in promoting infrastructure and education (Moran 1988; World Bank 1993; Lindauer and Roemer 1994; Meier 1995:313-326; Stern and Gugerty 1996; Stiglitz 1996; McDonough 1996; AsDB 1997; Radelet and Sachs 1998b). These results show that in order for African countries to achieve sustained growth and development they need to undergo a process that Harry Johnson (1964) referred to as "generalized capital accumulation".

Johnson's idea drew upon the historical lesson that *all* presently developed countries and *all* fast-growing developing countries have experienced sustained increases in both efficiency and productivity derived from broad-based improvements in the quality of human and other capital.[34] This point was not lost on African policy makers. All development plans in Africa, and more recently all public investment programs and policy framework papers, highlight the growth-enhancing effects of raising the standards of human and other capital. Unfortunately, a major gap emerged between rhetoric and action. In practice, economic policy choices and patterns of economic management across Africa have resulted in the deterioration in the quality of physical and human capital. This has been most evident in education where, despite an increase in average years of education per graduate, the quality of education has fallen, sometimes quite abruptly.[35]

African countries face the task of attempting to "catch up" to the rest of the world. This will require a major effort to expand human capacity through higher standards of education and improved utilization of all available capital.[36] Many approaches are possible, including the recent "knowledge for development" initiative of the World Bank.[37] These and other initiatives require major increases in investment. So far, few African countries have taken the steps needed to mobilize additional domestic resources for this to occur on a sustained basis. One of the many reasons has been the generally lukewarm effort to sustain trade and exchange rate reforms.

e. Foreign Direct Investment

For many countries, foreign direct investment (FDI) has helped boost capital accumulation. In addition to finance, FDI provides new technology, access to markets, and improved managerial skills (USTR 1996; Ndulo and van de Walle 1996; USDC 1997; ADB 1997; OECD 1998). An important goal of trade liberalization and exchange rate reform throughout Africa has been to raise the levels of FDI. Indeed, many countries have judged the efficacy of their economic reforms (at least in part) in terms of their ability to attract FDI.[38]

A major problem is that many African policy makers remain profoundly ambivalent towards FDI. Having spent years convincing themselves that FDI (and the "transnational capitalists" so often associated with such investment) were the source of their economic difficulties, most policy makers have difficulty "uncreasing their minds" about this issue. Starting almost immediately after they gained independence, most African governments began taking a hostile stance towards FDI. This behavior reflected the populist view that the country needed to control its own affairs so that it could be economically independent.[39]

Historical experience has shown that neither proposition bears much relation to the other. Indeed, by "taking control" African countries have regressed so dramatically that future growth and development will only be possible if they can attract external capital. As noted in section 2, most African governments cannot service their foreign and domestic debt in a non-inflationary way. Most have chronic budget deficits and many of their public enterprises absorb national savings rather than add to them. Furthermore, the resources being supplied by the donor community are at (or close to) their upper limits.[40] These factors suggest that the only viable option for achieving substantial increases in investment is through private capital inflows. So far, however, few African countries have been successful in this effort (Cockcroft 1992; Thomas 1996; UNCTAD 1996;

Bhattacharya *et al.*1997; Clow 1997; Sachs and Sievers 1998; Gastanega *et al.*1998; Harris 1999). Moreover, where FDI has flowed to Africa, it has been concentrated in a limited number of countries and then only for large-scale primary resource development (GCA 1996:Pt. II; *African Development Report* 1997:Table 1.8, Ch.4; Madavo and Sarbib 1997; Gastanega *et al.*1998). Such concentration, while not unexpected, has been unfortunate. It has reduced the availability of resources and management skills, technical expertise, quality control, and market access that private investors can provide to Africa.

Notwithstanding these unfortunate effects, the dearth of FDI has a more fundamental cause. Local businesses and their associates have not been enthusiastic about investing locally. These investors, who have detailed knowledge of local conditions, have been deterred from investing in Africa for many reasons – continued instability and its "neighborhood" effects, the absence of growing markets, the low level of locals skills, and transport and infrastructure problems. Locals have also been wary of investing because of continued "populist" opposition to private investment and FDI. African politicians continue to express their concern (in ways that reduce confidence) about the loss of control over major enterprises, especially if foreigners are involved. Responding to this opposition, African governments restrict the types of activities that foreigners can engage in and the share of particular enterprises they can own. Many governments remain reluctant to open up so-called "strategic" sectors – energy, telecommunications, and banking. Such restrictions simply discourage private investment without adding to national economic security (Bhagwati 1988).

An advantage of trade and exchange reform is that it requires countries to become more competitive internationally. As such, it begins to force African governments to confront the relative benefits and costs of "local control", restrictions on landholding by foreigners, the employment of expatriates, and so on. Facing these issues is fundamental to the process of economic liberalization.

f. Unit Labor Cost

Unit labor cost is the nominal wage multiplied by the exchange rate divided by the average product of labor. For a sector (or industry), it measures the dollar cost of labor input per unit of output. Trade and exchange rate reforms directly affect unit labor cost. A devaluation of the exchange rate reduces the dollar value of wages. And, the increase in international competition that follows trade liberalization helps moderate domestic wage pressures. Efficiency improvements, fostered by the removal of barriers to trade, raise the average product of labor thereby lowering the real wage cost per unit of output. These positive direct effects are easy to identify and influence with trade-related policies. Less evident and less amenable to manipulation are changes elsewhere in the economy. These can often raise wage costs and undermine improvements in labor productivity.

International studies of productivity differentials have shown that, despite low nominal wages, African countries have cost structures that prevent them from competing effectively in world markets (Lindauer and Valenchik 1994; World Bank 1995; Freeman and Lindauer 1999). The implication is that average wages in Africa have not been low enough to compensate for the over-valuation of the nominal exchange rate and lower levels of physical productivity. Much evidence exists to show that labor productivity has declined (and continues to decline). The macro data are revealing. In Africa over the period 1975 to 1996, the labor supply increased by 2.6 percent while real GDP increased by 2.2 percent. Thus, at an aggregate level, real income per worker declined. One reason for this was that the supply of capital (estimated using gross investment data) rose more slowly than the supply of labor thereby lowering the supply of capital per worker.[41] By contrast, outside Africa, both capital per worker and income per worker increased (ILO 1998).

Several recent studies have examined how African labor might become more competitive. They conclude that African labor *could* compete if unit labor costs were reduced. Based on "efficiency" wage arguments[42] and political experience, it would be counter-productive to cut nominal wages.[43] Therefore, unit labor costs will have to be reduced through the sustained depreciation of the real exchange rate and improved labor productivity. Ways of reducing the real exchange rate were discussed earlier. Methods for raising productivity are covered in a companion study (McPherson, this volume).

There are numerous potential avenues for reducing unit labor costs across Africa. The most obvious approach, namely liberalization of labor markets, has been resisted. Across Africa, formal sector employees typically comprise only a small proportion of the total work force. Nevertheless, they are influential, highly vocal, and often destructively demonstrative in supporting their claims. Many economic reform programs have foundered on labor issues. For example, the attempt in the early 1990s throughout the franc zone (most notably in Côte d'Ivoire) to reduce wages as a means of achieving a real devaluation of the CFA franc was abandoned in the face of opposition from organized labor. In 1998, Zimbabwe's budget unraveled when teachers and soldiers were given extraordinary wage increases. In South Africa, the government has had little success in curbing pressure for higher wages despite the existence of high unemployment among the black population.

Seen in historical context, the reluctance of African governments to deal with labor matters is understandable. Yet, at some point African leaders will need to follow the example of their counterparts in developed countries. During the 1980s, actions by Margaret Thatcher in the U.K., Ronald Reagan in the U.S. and Bob Hawke in Australia demonstrated that in order for their respective economies to move forward, the power of the most militant labor groups had to be curtailed.[44]

So far, no African leader has taken such a stance. Consequently, selected worker groups retain disproportionate economic power. South Africa is perhaps the most obvious example. Several "scenarios" have been computed suggesting that without major changes that raise investment and improve total factor productivity, growth will not revive (Brixen and Tarp 1996).[45] Some limited easing of trade restrictions and exchange controls has occurred and a trade protocol has been concluded with the European Union. Missing from the agenda has been broad-based reform of labor markets.

This has been a shortsighted approach to policy reform. Unemployment in South Africa is already high and economic growth is low. The failure to deal with labor issues has had an adverse effect on trade and exchange rate reform. Neither can be pushed aggressively because it would expose formal sector workers to the competitive pressures they have been using their market power to avoid (Stals 1997).

Recent evidence shows that openness to trade and the adoption of a liberal exchange rate regime does not necessarily reduce real wages. After some initial labor reallocation (perhaps with compensation for retrenched workers), real wages begin to rise (sometimes sharply) due to improved efficiency and increased output as the effects of increasing openness take hold (Mead 1990; World Bank 1995:Ch.7; Lensink 1996; Paus and Robinson 1997).

g. Physical Infrastructure

Empirical results from the *Emerging Asia* study (AsDB 1997) confirm that landlocked developing countries in the tropics face a range of special problems. Over the years, various commentators (Blainey 1982; Krugman 1991; Sachs 1997; Bloom and Sachs 1998) have emphasized the constraints to rapid growth when countries and communities are geographically isolated. In Africa's case, the effects of these constraints have been compounded by the general economic decline over the last two decades. This has diminished the “extent of the market,” decreased the degree of specialization, and undercut the benefits of the “division of labor.” In effect, for many countries the vision of development suggested by Adam Smith has “run in reverse.”[46]

Two adverse consequences stand out. First, the general decline in real per capita incomes has significantly reduced effective demand in most African economies. Even allowing for the shift of activity into informal channels, real incomes and real demand have fallen sharply.[47] The effects of declining real income have been evident in a number of ways. In some countries the share of income spent on food has increased. In others there has been food energy (or calorie) regression as well *(African Development Indicators* 1998/99, Table 8.6).[48] Both changes indicate economies that are under severe stress.[49] These effects have shown up at the aggregate level as an increase in the contribution of agriculture to GDP accompanied by an increasing share of roots, tubers, and plantains relative to grains in agricultural production.[50]

Second, the decline in specialization has reduced efficiency. As Africa’s economic difficulties have intensified, firms and individuals have had to become more self-reliant. Their response has been to revert to a variety of “coping” strategies and "safety-first" behavior. These have been both skill- and time-intensive. Especially evident among agricultural enterprises and firms that require foreign exchange and imported inputs, these trends have weakened (and often severed) many of the inter-firm and inter-personal economic linkages within the economy. It has also tended to reinforce geographical isolation by weakening inter-regional links.[51]

Declining specialization has compounded the difficulties created by distance and geographical isolation. Under most circumstances, these factors were believed to have a benign effect on growth.[52] Their significance has increased as Africa’s economies have regressed and unit costs have risen as per capita real demand has declined. Some authors have recently been highly critical of the neglect of geography and space in discussions of economic growth.[53] The merits of the criticism are questionable. For example, at one point development specialists and economic historians noted that “new frontiers” and “lands of recent settlement” gave a boost to economic development because distance (typically from Europe) provided a degree of “natural protection” to new industries (Schumpeter 1954:466-7; Nurkse 1970; Grigg 1982; Lensink 1996). Scholars tracing the roots of the “first industrial revolution” in the United Kingdom have highlighted the importance of transport and location.[54] Empire builders and students of colonial development could not (and did not) neglect the importance of space and distance.[55] Finally, agricultural economists have taken pains to analyze the economic effects of distance, location, and geography. Indeed, drawing on the work of J.H. von Thunen, agricultural economists have a long history of including spatial constraints and opportunities in their analyses.[56] For this reason, T.W. Schultz was especially careful to distinguish between the physical and economic supply of land. The former was the total land base in a country or region; the latter was the amount of land that, for given market conditions, generated a positive net economic rent (Schultz 1957).

Building upon these ideas provides a deeper understanding of the problems associated with distance and how improved infrastructure helps neutralize the cost disadvantages of particular locations. It also brings into sharp relief how declining effective demand can intensify the constraints associated with isolation and distance. African countries have no “natural protection” from a collapsing market. Indeed, the effect is compounded since the value of wealth also declines as the “economic supply of land” shrinks.

h. Irreversibility

The attempt to understand why policy reforms are not sustained raises questions of irreversibility and option values. As already noted, Africa has attracted only small amounts of FDI. Why have so few private investors taken an interest in Africa? Why has Africa been the last option rather than the last frontier?

The lack of investor interest shows up in several ways. Political risk agencies rank African countries as the most unstable and least “investor-friendly” locations in the world. Based on the United States Government’s own inter-agency risk assessment criterion, few African countries are eligible for official insurance and credit guarantees. In addition, criteria used by the U.S. Export-Import Bank rate most African countries as “unbankable.” While the actions of outsiders are relevant, it is the actions of locals which are more telling. Through capital flight, most African investors themselves have taken advantage of the more lucrative, lower risk investment opportunities outside Africa.[57]

The lack of investor enthusiasm for opportunities in Africa is fully consistent with theories of irreversibility and the option value of waiting (Pindyck 1991; Hubbard 1994; Severn 1996; Cuddington, Liang, and Lu 1996).[58] When investors are required to make an irreversible commitment to a specific project, there is often little to be lost (and potentially much to be gained) by delaying the investment, especially in the face of uncertainty about future government policy. With so many alternative investments available world wide, including the option to hold cash or “gilts”, investors need not expose themselves to unnecessary risks. However, for African governments the consequences of delayed investment can be devastating.

Based on their actions, many African policy makers have had trouble appreciating the implications of irreversibility and option values. The option of waiting is directly linked to the expectations formed by investors of future returns and the stability of those returns in a particular country. Policy makers who understood this would pay close attention to the impact of their actions on investor expectations.

The case of Zambia is instructive.[59] Following the elections of 1996, senior policy makers became convinced that the large-scale private (foreign) investment needed to rehabilitate and expand the mining sector would occur within two years. This would enable the country to meet all the conditions of the Highly Indebted Poor Country (HIPC) initiative by December 1998. The basic policy problem was how to “make it” until the effects of that investment began to have an impact on output, employment, and incomes and HIPC provided Zambia with an “exit” from its debt.

There were two ways to proceed. The first was for the government to agree to *and* meet the conditions of a World Bank/IMF adjustment program. This was not an attractive option because the bilateral donors (upon whom Zambia has depended for large amounts of external support) had attached conditions related to “governance.” The most worrisome conditions for Zambia’s leaders related to high level corruption and the sale of the copper mines. The second option was to ignore the governance conditions, forsake some donor support, and muddle through hoping the economy would not go too far off track. The government pursued the second option with disastrous consequences for growth and development. Zambia did not gain access to HIPC debt relief in December 1998 and the sale of the mines was delayed. The economy is now caught in a spiral of rising debt, declining real income, and collapsing expectations.[60]

Such an approach to economic management has been common in Africa largely because policy makers consider the effects of policy changes from their perspective rather from the point of view of those who are directly affected. Were policy makers to think strategically, they would attempt to understand the consequences of their actions and the expectations they generate. A key consideration should be to avoid behavior that undermines the confidence of investors and causes them to exercise their option of waiting.

i. Aid Dependence

For close to four decades, African countries have received massive amounts of donor support. The assistance has taken the form of balance of payments funding, debt relief, commodity transfers, and technical (as well as military) aid. As already noted, the share of aid in GDP has increased sharply in Africa since 1980. Some of the increase has been to address humanitarian problems associated with wars and drought. But the bulk of the increase has been designed to stimulate adjustment and reform. For most countries, this aid has done little to promote growth and development. For a start, one macroeconomic effect of foreign aid is that it has allowed real exchange rates to remain substantially overvalued. This has undermined attempts to promote trade reform.

There have been other problems. Since foreign assistance is provided to governments, it has systematically over-valued public sector activities at the expense of the expansion of the private sector.[61] This bias has continued over recent years despite the emphasis given by donors to privatization and the “non-government” sector.

A further effect has been to distort the incentives for reform. With few exceptions, foreign assistance has continued to flow to African countries despite their poor economic performance (Johnson 1997; World Bank 1998; Alesina and Weder 1999). This has supported the continued accumulation of private wealth irrespective of the quality of enterprise and the extent of innovation in the economy. All that has been required for this to occur is individuals who are willing to abuse their public sector positions or contacts for private gain (Sandbrook 1986, 1987; Parfitt and Riley 1989; Ayittey 1992, 1998).

Generally missing from donor programs in Africa is the recognition that the “effective” use of aid requires governments to act in ways that will “work” their countries off aid. Lacking this emphasis, aid programs remain open-ended and largely divorced from any notion of self-help. At one time, this idea was a principal motivation for, and requirement of, foreign aid especially, from the United States (USDS 1964; Bell 1965; Orme 1995). However, it was progressively dropped as aid agencies competed for influence and jostled to promote their own agendas (one of which has been to prolong their own activities).

For African policy makers with the foresight to look “beyond aid dependence” (which also involves looking “beyond the debt overhang”), the challenge is to adopt policies that enable the economy to mobilize adequate resources domestically. One aspect of such an approach would be the formulation of measures that induce local investors to keep their resources “on-shore” and use them productively. That would directly reduce dependence on foreign aid and begin to provide a sustainable basis for financing the domestic investment needed for stimulate growth and development.

The policy implications for most African countries of such an approach are clear (HIID 1997, McPherson 1999a). At a minimum, it would involve immediate efforts to further depreciate the real exchange rate, reform the financial system, enhance revenue compliance, reduce public expenditure, improve the efficiency of resource allocation, and eliminate value-subtracting public sector activities. All of these actions are consistent with improving macroeconomic management and promoting macroeconomic stability. With the exception of Mauritius and Botswana, most African governments have yet to become engaged in such an effort.

4. Preventing Policy Reversals

Two approaches to economic reform have been common. The first has been the "big bang" which seeks full liberalization with as little delay as possible. The second has been to spread the process out by systematically removing the major barriers to growth and development at each step along the way. Neither approach guarantees that the original reforms will be sustained. Both approaches have been equally susceptible to policy reversals.

Despite the approach taken, a key element in sustaining reform has been to prevent (or contain) backsliding. In Africa, tax reform and exchange rate reforms have been especially difficult to sustain. Governments often revert to *ad hoc* measures to raise additional revenue whenever revenue performance falters and they reintroduce controls on foreign exchange markets whenever the exchange rate comes under pressure.[62] Since trade taxes comprise a major part of government revenue, backsliding on tax reform reverses trade reform as well. Backsliding also occurs indirectly as actions elsewhere in the economy that support trade and exchange rate reforms are allowed to unravel.

Urging governments to remain committed or maintain the "will" to reform simply pushes the issue back one level. (Analysts then have to seek the "sources" of commitment and will.) The basic problem has been to ensure that policy makers maintain their focus on medium and long-term issues of growth and development. This has been especially difficult given the prevalence of short-term crises. When faced with a crisis, policy makers tend to heavily discount the longer-term gains from continued reform. The (apparent) short-term advantages of "doing something" often dominate. If pressed, most policy makers will confirm that consistent policies are vital for rebuilding confidence. They will also confirm that confidence is essential for fostering the behavioral changes (higher savings and investment and improved productivity) required for sustained growth and development. Yet, in times of crisis, consistency is often the first casualty.

There are few ways of preventing policy reversals when governments are determined to change course. Donor conditions are often ineffective and so is foreign aid (Burnside and Dollar 1997; World Bank 1998; Dollar and Easterly 1999). A more robust approach to the prevention of policy reversals is the development of a set of mutually reinforcing mechanisms that allow policy makers to remain aware of the damage caused when economic reform is reversed. The intention is to create a setting that reduces the probability that policies will be reversed. We discuss several approaches below. These include: a cost-benefit analysis of policy reversal, market discipline as a guide to economic activity, support for trade and exchange rate reforms by the national leadership, a strategic vision of economic reform, re-emphasizing agricultural development, regional trade and broad-based liberalization, and adopting a simplified policy agenda.

a. Relative Costs of Policy Reversals

A major antidote to policy reversals is to improve the quality of economic analysis from which policy reforms are derived. This is part of the more general problem of "enhancing capacity" in the key economic ministries and departments.[63] Frequently the timely reminder to senior decision makers that decisions they plan to take reverse previous reforms can lead to reconsideration. These reminders, however, are rarely effective unless plausible alternatives are provided.

One way of engaging senior government officials is to highlight the relative costs and benefits in terms of growth and development of sustained versus erratic patterns of trade and exchange rate reform. A small number of alternative scenarios can illustrate the effects of policy reversals on growth and development. There are now many examples from Africa of the adverse effects of backtracking on policy reform. One approach is for analysts to rework some of these examples to what was gained and what was lost by the policy reversals. This helps "localize" the experience. It also helps policy analysts to understand the concerns (and issues) that led policy makers to reverse earlier policy changes.

Another approach is for analysts to highlight the costs to African countries of *not reforming* despite almost two decades of structural adjustment. To date, the literature has overwhelmingly focused on the (so-called) costs of adjustment. That focus has been unfortunate since the costs of not adjusting have been far more severe.[64] Across Africa, poverty and under-development *have* intensified, real incomes *have* declined sharply, and the continent *has been* marginalized within the world system of trade and exchange.

Analysis of the costs of not adjusting would also serve to illustrate the various inter-connections among policy actions. For example, policy makers may not be aware that they are reversing trade reform when, after having realigned the exchange rate they raise tariffs as a means of closing a "financing gap". The analysis, however, would show that while a change in the exchange rate provides uniform incentives to exporters and import-competing activities, raising tariffs distorts further the degree of effective protection provided to specific types of activities that use imported inputs or compete with imported products.[65] A further advantage of this focus is that it demonstrates to leaders and senior officials the benefits of "opening up" the policy process.

Zambia's experience illustrates this point. For a period following the 1991 elections, economic policy was overseen by a "Technical Committee of Economic Ministers."[66] The oversight provided by this Committee helped maintain a high degree of consistency among the policy changes and gave a clear direction to macroeconomic policy. The Committee provided senior policy makers with an informal forum for considering the connections among the various economic reforms. Because the Committee met regularly it allowed the government to respond rapidly to changes in economic conditions. Under its stewardship, the Zambian economy improved significantly. The Committee ceased meeting after December 1994.[67] Within a few months, economic policy lost direction.

b. Increasing Reliance on Market Discipline

Many observers have attributed a large number of Africa's economic difficulties to government manipulation of key economic variables over extended periods. This generated widespread distrust among the public of the government's ability to intervene in the economy in ways that were even-handed, transparent, fair, and constructive. Such experience reinforced public skepticism of new government initiatives. The public has come to expect that most policy initiatives will be reversed or modified once circumstances change.

To rebuild public confidence, African governments have to minimize the possibility of re-intervening once they liberalize the economy. One approach is to open up as many markets as possible so that the consequences of policy reversals on prices, incomes and other major variables stand out.[68] Because the political and economic stakes are so high, an important place to start is the foreign exchange market.

The appropriate type of exchange rate regime – fixed, floating, or managed float – has been widely debated (Johnson 1973; Crocket and Nsouli 1977; Isard 1978; Quirk *et al*. 1987; Killick 1987; MacDonald 1988; Edwards 1989; Srinivasan 1991; IMF 1992; Quirk and Cortes-Douglas

1993; Sahn, Dorosh, and Younger 1996; Asea and Reinhart 1996; Duesenberry *et al.*1996; Stryker 1997; Cooper 1999). As already noted, most African governments have opted for some form of exchange rate control (even as they publicly profess non-intervention). By following this course of action policy makers diminish the prospect that exchange rate reform can make a *sustainable* contribution to growth and development. A further problem is that governments do not conscientiously protect the gains of liberalization. They tend to presume that, once action has been taken to rationalize the exchange rate, its positive contribution to growth and development will persist. An example is the 1994 devaluation of the CFA franc (discussed in annex B). Since the franc zone countries have retained a fixed exchange rate, in order to sustain the real effects of the 1994 devaluation, they need to remain attentive to the effects of *all* their macroeconomic policies.

The easiest and potentially most important confidence-boosting approach to exchange rate reform across Africa is to float the exchange rate.[69] The widespread existence of parallel exchange markets is evidence that the general public recognizes and understands the benefits of a floating rate. The difficulty has been convincing senior policy makers of those benefits especially in countries subject to frequent shocks.[70] When external shocks occur, government officials tend to believe that they should re-intervene. Empirical research reveals that intervention is more likely to intensify the disruptive effects of shocks rather than offset them (Bevan, Collier and Gunning 1989, 1990; Asea and Reinhart 1996).

Similar observations apply to other areas of market liberalization. Sustained reform of agricultural marketing systems throughout Africa has been particularly difficult to achieve. After years of manipulation, including the widespread imposition of pan-territorial and pan-seasonal prices for inputs and outputs in many cases, governments have been reluctant to accept the types of regional price disparities and seasonal price movements consistent with the efficient operation of agricultural markets. By re-intervening to prevent farm-gate prices from falling and capping the increase in consumer prices, governments undermine incentives that are essential to price discovery and price formation. The pressures to re-intervene in agricultural markets are compounded by the benefits to senior officials in government and marketing agencies of kickbacks linked to the import and distribution of fertilizer and food grain.[71] Such intervention, however, undercuts the contribution that agriculture can make to export growth.

c. Support of National Leaders [72]

Discussions of the effectiveness of structural adjustment regularly mention the need for, or importance of, “political will” or more recently “ownership.” Defining these terms in an African context where aid dependence is acute is far from clear. For a start, they are circular. Countries that reform do so because there is political will or ownership. When countries do not reform, it is taken as evidence that there is a lack of will or ownership (Goldsmith 1998). The terms are also arbitrary. Positive expressions of “will” or “ownership” tend to reconfirm what the specific commentator finds constructive. For example, the bias in this essay is obvious. Given my focus on trade and exchange rate reforms as instrumental in promoting growth and development, my attention has been drawn to actions that promote these reforms. Policy actions that do not promote them reforms directly or indirectly are ignored.

In practice, however, all politicians have the “will” to act in a specific way or to show some “ownership” of particular policy initiatives. Observers may not agree with the choices being made, but that is beside the point. The basic question is whether policy makers act in ways that foster growth and development. For this study, that requires sustained trade and exchange rate reform.[73]

A major problem has been to ensure that national leaders become engaged in the issues related to economic reform. A further problem has been to convince them to avoid opposing reforms with which they are not directly engaged. As noted in section 2, policy reform involves risks. Most leaders wish to be seen as “reformers” without having to be directly associated with specific reforms lest these reforms fail and they are implicated. Leaders need a fallback position (a "fail-safe" strategy). A common stratagem is for the minister of finance to take the lead in promoting economic reform.[74]

Some relatively risk-free approaches are available through which national leaders can help move the reform process forward. It will, however, require their attention to take advantage of selected opportunities. For instance, most African leaders emphasize the need for expanding nontraditional exports (NTEs) (Salinger, Savarese, and Amvouna 1996). This was the case when East Asia’s exports began growing rapidly. African leaders need encouragement in understanding how they can provide the support that was typical among the Asian leaders who ensured that concrete measures for promoting NTEs were adopted.

An African leader who is convinced of the potential growth contribution of expanding NTEs could take several steps. He/she could constitute and supervise closely task forces of officials and private businessmen/businesswomen from sectors with export potential. (For most African countries a key sector would be agriculture.) The task forces would set detailed goals for export expansion by individual enterprises and would identify measures necessary to achieve those goals. The leader would facilitate the measures and arrange rewards for performance. No doubt the leader’s time has a high opportunity cost. This would have to be set against the potential returns from his/her other activities. Yet, as shown by countries that have grown rapidly through export expansion, this encouragement of exports would be a highly constructive use of the leader’s time.[75]

The experience of several rich countries reinforces the need for engaging national leaders in reform. While most African countries have been slow to reform, some rich countries have made structural changes that have been far more comprehensive than anything attempted in Africa so far. This is ironic since, by definition, rich countries have the resources needed to finance their macroeconomic imbalances should they need to. To avoid incurring the additional debt and to rapidly restore their international competitiveness several rich countries – Sweden, New Zealand, Australia, the United Kingdom, and Ireland --- have implemented radical reforms (Lafay and Lecaillon 1993; OECD 1994, 1998; Evans *et al.* 1996; *The Economist* 17th May, 1997:17-24). Essential to the success of these programs were leaders who understood the need for rapid reform and became fully engaged in promoting it.

d. Strategic Vision

Fundamental to good leadership is strategic vision, i.e., a sense of how the principal trends (economic, social, and political) shape a country's future and how the trends might be influenced to enhance that future. To decide whether reform is required, visionary leaders generally "cast their minds forward" as a means of understanding the implications of allowing current policies to continue. When this exercise reveals a high probability of undesirable outcomes, the leader seeks ways of moving the economy away from its current trajectory. Such an exercise led Sweden's leaders to begin taking measures to reduce the budget deficit from 14.9 percent of GDP in 1993 to a surplus of 1.2 percent of GDP by 1998.[76]

Much has been made of the weak capacity in Africa. Capacity, however, is multi-dimensional and is rarely uniformly weak. Effective leaders require "strategic capacity" or the ability to understand a problem within its broader (dynamic) context (Mann and McPherson 1981; Cohen and McPherson 1983; Grindle, Shipton and Mann 1989). *Ad hoc* responses to short-term events are evidence of the lack of strategic capacity. A common error by policy makers is that in the face of so many constraints, they often believe they cannot afford to take a longer-term view. Yet, it is precisely when governments are severely constrained that senior policy makers need to keep all circumstances in perspective. This will help them avoid repeating mistakes and taking decisions that unnecessarily narrow their future options.[77]

A critical aspect of "casting one's mind forward" is to appreciate the importance of expectations. The first question policy makers who intend reversing an earlier reform should ask themselves before they act is: what impact will such reversals have on the economic behavior of the general public? In particular, they should ask how the prospective outcomes of future policy reform will be seen by investors (local and foreign) when policy makers reverse earlier policy initiatives.

Experience across Africa shows that most reforms are reversed with little concern for the longer-term implications for consistency, credibility, and reputation. This is unfortunate for it is evidence that policy makers remain more concerned about their own narrow interests than the broader questions raised by irreversibility and option values. As noted earlier, the cost of waiting for most investors is not a major inconvenience. But, for African governments, the cost of having investors "sit on the sidelines" can be high. Zambia provides an example of the extreme costs associated with government indecision about when and how to sell the copper mining company. The cost to the country (as distinct from the cost to the few "insiders" who helped strip the company's assets) of the seven-year delay has yet to be fully computed. It will run into billions of dollars.[78]

Another issue requiring a strategic view is the most appropriate way that African governments interested in reforming might have their countries catch up with the economic performance of the rest of the world. There are several potential approaches. The 1998 *World Development Report* makes the case for expanding knowledge to take advantage of improvements in high-tech communication.[79] Although the report has useful insights on the role of information and knowledge on economic and social development, it provides little guidance to countries, intent on catching up, on how to allocate their limited resources. Attempting to engage all (or even most) individuals and firms in the information revolution will dissipate the effort. Concentrating resources, however, raises questions about the ability of public officials and institutions to "pick winners." It also raises equity concerns because those who have access to special training may find emigration in search of higher wages the most lucrative alternative.

Another issue requiring a strategic vision relates to the institutional impact of the HIV/AIDS pandemic. To date, much attention has been devoted to efforts to prevent the spread of AIDS. For example, USAID has devoted considerable resources to "social marketing" of condoms. This is important but it needs to be supplemented with action to prevent the erosion of skilled personnel from undermining the integrity of key organizations.[80] Little of substantive nature has been done to come to grips with the implications of the attitudinal changes that occur when large segments of a population face the prospect of premature death. Countries in Southern Africa have been especially hard hit in this respect. As a potential stopgap measure to help prevent further institutional decline, African countries might mobilize international support for special programs of technical assistance. The goal would be to stabilize the performance of the key government organizations – ministries of finance, central banks, revenue departments, and so on – until the full flush of the epidemic passes, or alternative arrangements are made to drastically scale back government operations to levels consistent with local supplies of skilled personnel. In either case, some strategic thinking about these matters is long overdue.

All of these matters have both direct and indirect effects on trade and exchange rate reform. The strategic choice is whether to attempt to improve the conditions for all traded goods and services or to focus on only some. Broad-based reforms stimulate more generalized approaches to liberalization. Narrowly focused reforms require concentration on selected dimensions of trade, through, for example the establishment of export processing zones (EPZ's) (Alter 1991; Bradley 1999).

e. ***Re*-emphasizing Agriculture**

While African governments have lacked the capacity to *promote* development across a broad front, the experience of agriculture demonstrates that government intervention can *block* development. Agriculture in Africa remains under-developed (and in some countries highly lop-sided or "dualistic") largely due to government interference. The sector has performed poorly because of *too much* official attention of a fundamentally destructive kind.

An important advantage of *re*-emphasizing agriculture is that it directly engages policy makers in the attempt to improve the welfare of the majority of the population (Eicher 1992; Block 1994; Schioler 1998). More than half Africa's labor force is still in agriculture and related activities. No scenario for long-term growth and development in Africa is plausible without comprehensive improvements in agriculture.[81] Furthermore, no scenario for sustained trade and exchange rate reform is plausible without a major contribution from agriculture. Whether these occur will be affected by a number of factors.

First, long term global influences are mixed. China's (and Asia's) ability to continue producing adequate supplies of food and fiber is problematic, especially as consumers begin to demand more grain-intensive (and hence land-intensive) products such as meat and milk. Productivity continues to improve in agriculture in both the United States and Europe.[82] The rate of improvement is likely to slow in the face of modifications to the Common Agricultural Policy and the decline in U.S. subsidies. By contrast, agricultural productivity is also expected to rise in Russia and the former Soviet Union as economic stabilization and structural adjustment proceed and privatization raises the rate of investment in agriculture. Although these trends point to a number of offsetting influences, none of them should hinder the expansion of agriculture across Africa. Total grain production in Africa roughly matches the seasonal "carry-out" of the United States.[83] And, Africa's contribution to world supplies of trade in livestock products remains small. Overall, the continent is decades away from the prospect of having its agricultural output constrained by the lack of world demand. With appropriate real exchange rate management in Africa, shifts in supply on world markets will not be a problem either.

Second, African countries on average import large amounts of food (*African Development Indicators* 1998/99 Tables 5-35, 5-36).[84] Local producers would directly benefit from efficient import substitution. By their choices of exchange rates, infrastructure investment, tariffs and other macroeconomic policies, African policy makers have demonstrated to date that they would rather support agricultural development abroad than within Africa. A major boost for trade and exchange rate reform across Africa will come when there are policy changes (primarily real exchange rate depreciation) that enable African countries to replace staple food from abroad (as aid and imports) with local production. It is especially important that food aid be replaced. While the relative benefits and costs of food aid have been debated for years (Schultz 1960; Johnson 1967; Srinivasan 1989) recent evidence has more concretely confirmed the long-term negative effects of food aid on Africa's food production (Sahn and Sarris 1991; Lavy 1992). African agriculture would be given a major boost if countries devised and implemented a "food aid exit" strategy.

Third, the gap between actual and potential output in African agriculture is much larger than elsewhere.[85] This has positive implications for future output growth. Given appropriate incentives and improved access to proven technology, African farmers have the prospect of achieving sustained long-term increases in output. The improved food supply during the mid-1990s was widely attributed to better rainfall. Weather patterns will not always remain so favorable. Nonetheless, improved water management techniques would help maintain some of the recent production response.

Fourth, although recent research has re-emphasized the role of distance and tropics in African development (Kamarck 1976; Eicher and Baker 1992), the major constraints on African agriculture continue to be policy-induced (Harrison 1987; Lele 1989; Svedberg 1991; Stern and Gugerty 1996; Barry and Beltchika 1996; Radelet, Sachs and Lee 1997; Sachs and Warner 1997; Yeats *et al*. 1997). That is, despite location and climate disadvantages confronted by African agriculture, policies that promote efficiency and innovation would help Africa raise its rate of growth and thereby improve overall welfare. Ideally, policy initiatives should focus on strengthening growth linkages within agriculture and between agriculture and the rest of the economy (Delgado *et al.* 1998).

Cross-country experience over the last three decades shows that sustained trade and exchange rate reform requires action on all areas relevant to international competitiveness (Myint 1979; Nash 1993; Metzel and Colvin Phillips 1996; Lall 1999). This does not mean that all difficulties have to be remedied immediately or that all obstacles have to be removed at once. (Annex C discusses the role of sequencing of policy reforms.) Yet, for reform to be effective, the changes undertaken have to be comprehensive, accomplished relatively quickly, and sustained. Such an approach will benefit African agriculture over both the short- and long-term.

f. Broad-based Liberalization

As noted in section 2, critics of structural adjustment have argued that the World Bank/IMF methods for restoring macro-economic balance are flawed.[86] Supporters of the Bank and the Fund, however, turn the argument on its head. They point out that few, if any, African governments have seriously attempted to promote reform on a sustained basis (World Bank 1994; Lal 1994; Bouton, Jones and Kiguel 1994; Demery and Squire 1996). All of the major policy instruments needed to reform the economy, such as control over the budget and money supply, depend on the actions of the respective governments. In practice, *if* sustained growth and development had been high priorities for African governments, the policies needed to restore macroeconomic stability would not have been reversed so readily or so often.

It has been common for African governments to argue that most of their problems, including delayed adjustment and slow growth, have been due to factors outside their control.[87] These factors have also been cited as reasons why African countries abandon their adjustment programs. Examples include: drought, transport disruptions, strife in neighboring countries, rising world interest rates, falling world commodity prices, fluctuating terms of trade, and the decline in donor flows.

Another external factor that has been emphasized by African leaders has been the “new protectionism.” Some of the criticism is valid (Bhagwati 1988; Lensink 1996; Gillis *et al.* 1996; Lall 1999). Nonetheless, protection in developed market economies has not been the fundamental reason why African countries have performed so poorly for so long. Indeed, the cumulative effects of numerous trade reforms – Geneva, Dillon, Kennedy, Tokyo, and Uruguay Rounds – have reduced the average tariffs in rich countries from 40 percent to 5 percent. Critics argue that this is only window-dressing because non-tariff barriers (NTBs) have been raised as tariffs have fallen (Nogues, Obechowski, and Winters 1986; Baldwin 1989; Michaely, Papageorgiou and Choski 1991; Yeats *et al*. 1997). However, on balance, the structure of protection has been dismantled. Moreover, under the Lomé Convention and extensions of the General System of Preferences, African countries have received special access to European Union and United States markets.[88] Indeed, this process had proceeded to the point that changes made in the Uruguay Round will have a mixed impact. African countries will gain market access but at the expense of some of their existing protection (World Bank 1997).

Those who attribute Africa’s economic problems to protectionism have difficulty explaining why world trade as a whole has expanded so rapidly and so consistently. Over the last three decades, both the volume (and value) of world trade has increased at more than double the rate of world income. Furthermore, if protection had been such a barrier to trade, why were so many of the (so-called) "basket cases" of Asia of the mid-1960s able to use trade to transform themselves into newly industrialized countries (World Bank 1993; Stiglitz 1996; AsDB 1997)? The implication is that Africans who seek explanations for their poor performance need to look elsewhere for their marginalization within the world system of trade and exchange (Collier 1995; World Bank 1995:Ch.4; Lensink 1996; GCA 1996; Yeats *et al.* 1996, 1997; Rodrik 1998).

In seeking these answers, policy makers should be attempting to understand what pattern of trade and exchange rate reform would help sustain high rates of export growth. Because African governments (and most other governments as well) have such a poor record of "picking winners"[89] the most appropriate response would be for them to remove as many barriers to growth and development as possible through broad-based liberalization. Such a comprehensive change in policies related to trade, exchange rates, tariffs, macroeconomic balance, and infrastructure is more likely to have a greater impact on export growth than more narrowly focused improvements. This, of course, is what the rapid expansion of non-traditional exports from Africa has shown when governments remove barriers to trade (*African Development Report* 1997; Madavo and Sarbib 1997; Stryker 1997; *African Development Indicators* 1998).

g. Regional Trade

Because of the deep reservations many African policy makers have about the impact of "full" liberalization, one way of moving a highly distorted country forward is by opening up within the context of a regional trade agreement. Many African leaders have been attracted to the idea of regional integration.[90] In principle, this allows their countries to overcome the disadvantages of small markets, remoteness, and a limited production base without fully embracing the rigors of free trade. This approach to expanding local markets is not new. Numerous groups have been formed with the goal of fostering closer association among neighboring countries. Looking further to the future, African countries have a commitment, made through the Abuja Declaration of 1991, to move the whole of sub-Saharan Africa to a common market by the year 2020.

Though the plans have been bold and the intentions admirable, action so far has been timid and halting. Even when allowance is made for parallel market activity, intra-African trade and financial flows remain extremely modest.[91] A major problem has been that most African countries cannot agree to trade on a bilateral basis let alone agree in ways that would make multilateral relationships effective (Hawkins 1993; Mukherjee and Robinson 1996; AERC 1997; Oyejide, Elbadawi and Collier 1997; Gibb 1998). A current example, mentioned earlier, is the special trade accord between South Africa and the European Union. This agreement was pursued aggressively by South Africa. In the meantime, South Africa's commitment to work with its Southern African partners to expand trade and investment has languished.

Under present circumstances, most regional trade groups in Africa offer few advantages. Many of them overlap in confusing and disruptive ways. They also divert scarce resources (skills, effort, and finance) to largely fruitless efforts associated with making marginal additions to small markets. They also divert attention from the larger challenge of ensuring that African countries become fully integrated into world trade and commerce.

For that to happen, all African countries should simultaneously liberalize their trade and exchange rate systems. Experience the world over has shown that openness is a far more potent influence on market expansion and growth than special trading relationships (Thomas, Nash *et al.* 1991; McMillan 1992; *Economist* 1995; Bhagwati and Krueger 1995; Bhagwati and Panagariya 1996; Vamvakidis 1996; Hertel 1996; Harrison 1996; Fernandez 1997; Radelet 1997; Rodrik 1998; OECD 1998; Lall 1999; Dodzin and Vamvakidis 1999). The emphasis on regional relations has blurred this simple but powerful lesson.

Nevertheless, the regional focus has produced some important results. For example, many African countries have begun to *re-emphasize* the role of infrastructure as a factor in development.[92] This issue is helping open the way for substantial gains from multi-national cooperation. For some observers, the renewed emphasis on infrastructure raises the question of whether a "big push"[93] in this area would help African countries offset some of the disadvantages of economic and geographical isolation. Such efforts provide a foundation for future regional cooperation. Indeed, a number of countries that have failed to cooperate on multi-lateral trade liberalization have begun to cooperate in large, integrated regional infrastructure projects.[94]

h. Keeping the Message Simple

Economic reform is highly skill-intensive. For success, most of the key relationships within the economy have to change. A major problem already noted is that the reform agenda promoted by the international agencies is too complicated and too ambitious. There are far too many conditions for developing countries (especially those in Africa) to establish priorities, implement the relevant policies, and maintain them.

A considerable part of the problem is that the donor agencies themselves cannot decide what is fundamental for development. This produces sharp changes in the development agenda. For example, the World Bank through its *World Development Report* has now effectively institutionalized an annual cycle of rediscovering (or uncovering) what is believed to be important in development economics.

To illustrate, the 1994 WDR noted:

> Infrastructure is no longer the gray backdrop of economic life – underground and out of mind. It is front and center in development. (p. 12)

Infrastructure may have become a priority in 1994. It was not "front and center" before that; it has not been that way since. Indeed, infrastructure has been yet another initiative that World Bank officials have added to poverty (WDR 1990), environment (WDR 1992), health (WDR 1993), workers (WDR 1995), plans and markets (WDR 1996), the State (WDR 1997), and "knowledge" (WDR 1998). The one constant is that each year the Bank's focus will shift.[95]

The outcome in Africa has been unfortunate. Each new initiative further intensified the pressure on Africa's limited capacities. The net result, illustrated by the example in Annex A, has been the serious over-extension of the administrative and technical capacities of most African governments.[96] Needing donor support, African governments typically agree to donor conditions. Yet, as part of the ongoing "game" between African governments and the donor community, few people on either side expect that governments will fulfill their commitments. In this respect, non-performance and policy reversals have been pre-programmed.

It is worth noting that Asia did not develop in this way. Asian countries did not clutter their reform agendas (Lindauer and Roemer 1994; Perkins 1994). Many activities were downplayed (or postponed) until they became a major constraint to growth and development.[97] Asian countries grew rapidly by not attempting to achieve too much too soon. African countries could learn from that experience.

The basic issue for reform, however, is neither the number of conditions nor their breadth. It is critical that reforming countries implement and sustain the reforms that are essential for economic revival. That would place a premium on the ability to distinguish what is crucial from what would be desirable if there were fewer constraints. For trade and exchange rate reform, the dictum used by Robert Chambers – simple is optimal – provides a useful starting point (Chambers 1978).[98]

There are many ways to simplify the policy agenda. Major efficiency gains could begin to accrue if governments would clear away the host of complex and (often) contradictory regulations. There is little justification for exchange controls, multi-layered tariffs, export taxes, restrictions on land ownership, or discrimination against foreigners in employment. One of the election slogans used by Zambia's Movement for Multi-Party Democracy as it sought to displace President Kaunda and his party was that "the government has no business in business." The argument could be extended to any circumstance where the government's intervention is not fair, effective and honest.[99]

Simplifying the agenda would focus the government's attention on the key issues required to stabilize and revive the economy through the promotion of trade and exchange rate reform. No government has the capacity to make all the changes needed to promote reform. At present, African governments have the worst of both worlds. They are attempting to promote comprehensive reform without having acquired the necessary experience or capacity. Accordingly, the most effective approach would be to emphasize the few major changes that would provide the foundation for reform, implement these, and sustain them. As performance improves and experience accumulates, the agenda could be broadened.

i. Overview

Has the message been over-sold? Has the recent financial turmoil in Asia and the inability of Japan to formulate and sustain its own (long overdue) structural adjustment program undercut the value of lessons that African countries might draw from elsewhere? In my view, the answer is no. The adjustment imperatives for Africa, namely, to remove external and internal imbalances so as to create the conditions for sustained growth and development remain valid (and pressing) whether or not formerly successful countries experience difficulties. Indeed, these issues have become more significant, not less, in view of the debate over the sources of the "East Asian Miracle" and the recent financial difficulties (Gillis 1998; Radelet and Sachs 1998b; Krugman 1998; Perkins

1998; Pink 1999). Many factors were associated with the rapid growth; some of these were also associated with the financial meltdown. Growth specialists and others have recently highlighted the opportunities for "learning-by-doing" (Solow 1997) and "learning-by-trading" (Pissarides 1997). In addition to these lessons, there is also a need in African countries for "learning-by-reforming" (and vice-versa).

There are also useful lessons from the way that each country responded to the financial turmoil. Some adjusted rapidly and gained (Philippines and Korea); some resisted and lost (Indonesia). Useful lessons can also be derived from the experience of countries that did not collapse (China and Taiwan). One of these is that exchange controls do not protect countries from turmoil. China has exchange controls (though they leak); Taiwan does not. The basic difference for the countries that were relatively unscathed by the turmoil is that they had large foreign exchange reserves and were not burdened by major macroeconomic imbalances (including over-borrowing). The immediate lesson for African countries is the need to reestablish and maintain macroeconomic balance. One of the most effective ways of doing this is through trade and exchange rate reform. A further lesson is that macroeconomic balance, once established, is an important way of *sustaining* trade and exchange rate reform.

A note of caution seems warranted. Some African policy makers have observed that the Asian export-oriented model does not apply to their countries, primarily because of the way that open systems expose a country to external shocks. This opinion can best be assessed in the light of historical evidence. In 1960, Zambia had a per capita income exceeding that of Korea. At that time, Korea was *the* “basket case” of Asia, and Zambia was *the* “rising star” of Southern Africa. By late 1997, when Korea began to experience financial difficulties, its per capita real income was more than twenty times higher than the per capita real income in Zambia. The analogy can be carried further. Korea has begun to recover from its difficulties and the economy is growing again. Zambia continues to contract. A similar comparison could be made for many other countries. Africa has plenty of scope for growth and dynamism by drawing upon, rather than rejecting, lessons from Asia’s experience.

5. Concluding Comments

Mechanisms for *sustaining* economic reform typically involve a combination of enhancing the rewards of constructive changes and increasing the penalties for delay. But, who is a legitimate (or acceptable) arbiter when judging economic performance? Over the last two decades, that role has been assumed by donor agencies. They have sought to reward good performance through the provision of additional foreign aid and to ensure compliance by attaching conditions to their aid.

The performance of African countries casts doubt on the wisdom of this approach. Billions of dollars of foreign assistance and literally thousands of conditions have not produced sustained economic reform. Moreover, they have not left African countries better placed to move forward. The focus needs to shift from rewards and conditions to economic performance based on government self-restraint. For any government, a key feature of self-restraint is that policy reforms, once implemented, are not reversed.

This chapter has suggested several ways to help reforming governments avoid policy reversals even in the face of intense pressure. These include: focus on (and, if necessary, publicize) the costs of policy reversals; highlight the costs of not adjusting; emphasize confidence-building measures; give prominence to specific changes within the broader strategic setting; and keep the reform agenda simple by stressing the basic features of reform.

Remaining committed is never easy especially if those who oppose reform are well organized and financed. Nonetheless, reformers now have a rich body of international experience to help them deal with and deflect opposition. All examples of successful reform have involved government self-restraint, the enhancement of national self-reliance in areas such as agriculture, and the maintenance of prudent macroeconomic management. More generally, successful reformers have benefited from open public debate on economic policy, transparency in decision making, and accountability among senior policy makers.

A pressing challenge for reform-minded leaders in Africa is to move beyond their country's over-dependence on foreign aid. To this point, such over-dependence has locked most African countries into a pattern of minimal reforms consistent with the requirements of keeping the aid flowing. A relevant question is whether *any* of the present approaches to adjustment in Africa will result in sustained trade and exchange rate reform while aid flows continue to dominate budgets and balance of payments. This question has not yet been answered. With continued aid, most African countries have little incentive to change in ways that will sustain growth and development.

A potential cost of reform is the risk that circumstances will go awry. Yet, a certain cost of not reforming is that economic circumstances will deteriorate. The suggestions offered here will not guarantee that reforming countries will sustain trade and exchange rate reform and thereby grow and develop. But, if implemented, they will create the conditions that will help prevent policy reversals. For many African countries that alone would be a major step forward. It would provide them with the means of rising above the chaos and disruption of the last three decades and begin laying the foundation for an expansive and more prosperous future.

Annex A: Over-Extended and Inconsistent Policy Agenda: The Case of Ethiopia

In early 1998, I analyzed the main components of macroeconomic policy in Ethiopia as part of an assignment to develop a small, short-term projection model for the economy.[100] This analysis revealed a highly detailed and ambitious macroeconomic reform program. Ambition in any undertaking is admirable. Yet, it needs to be tempered by a realistic assessment of what can be achieved. Commitments to reform generate expectations of performance. When these are unfulfilled, the whole reform program is thrown into question and might easily unravel.

The controls and rigidities imposed by the regime prior to 1991 undoubtedly made policy makers anxious to liberalize and "open up". No small country, Ethiopia included, can expect to grow and develop when the state dominates the economy and barriers to entry and competition remain. Thus, the direction of the government's policy made sense. The problem was in the details of the reforms. There is plenty of cross-country experience on the type of reforms that are feasible, the time required to implement them, and their potential impact. Based on this experience, my review of Ethiopia's policy reform matrix raised three issues:[101]

First: The government does not have the capacity to implement the reforms to which it has agreed.

Second: Some commitments cannot be fulfilled either as stated or in the time allotted.

Third: The implementation of some measures, especially the "stroke-of-the-pen" reforms, could be accelerated with positive effects.

a. Government Lacks Capacity

The 1996 submission by the government to the Consultative Group for Ethiopia contains conditions in eight substantive areas: macroeconomic policies, structural and institutional policies, sector policies, data base improvements, human resource development and population, environment, poverty alleviation, and external sector policies. Together these contain 39 separate "objectives and policies" and 87 "strategies and measures." This would be an extravagant agenda for a developed country[102] let alone a country such as Ethiopia that has been in the process of reconstruction and has severely limited institutional and technical capacities.

An immediate question that arises is why the government agreed to so many conditions. Based on its performance from 1991 to 1996, most of the conditions would not be met. Why did the government agree to pre-program failure and non-performance?

Beneficial reforms should not be delayed if they can be feasibly implemented. But, in view of the government's known institutional weaknesses, nothing is gained by creating unrealistic expectations. As noted in the text, the Ethiopian policy matrix is an extreme example of the *carte-blanche principle*. There is no chance that the government can meet all of the conditions that have been agreed. Nonetheless, both the government and the donors continued to pretend otherwise. This is not the way to promote reform on a sustainable basis.

To place the reform effort onto a realistic footing, the number of conditions should be drastically reduced and the types of conditions agreed to should be modified. Only those conditions that can meaningfully contribute to economic reform in a major way should be retained. The remainder should be dropped from the immediate agenda.

b. Commitments that cannot be fulfilled

Based on cross-country evidence, these are commitments that other countries have been unable to implement or implement in the time frame indicated. Some examples follow.

- Tax policy: "expand use of presumptive taxation (including withholding taxes in the non-public sector)."
- Tax policy: "implement agricultural income tax...." during 1996/97.
- Financial system: "establish adequate legal, regulatory, and prudential framework for bank and non-bank financial institutions" during 1996/97.
- Private sector development: "strengthen or set up one-stop investment offices in the center and regions."
- Ensure efficient contract enforcement: "provide a fast track for adjudication of cases, help reduce defective contracts, and discourage excessive litigation" during 1996/97.
- Reduce population growth rate: "implement education, training, and counseling on productive health and family planning" during 1996/97 and 1998/99.

The ultimate value of these measures is not an issue. But, given Ethiopia's circumstances, attempts to implement these reforms are more likely to create frustration, resistance, and wasted effort than promote economic reform.

"Presumptive taxation" is arbitrary, capricious, and a guaranteed way to foster corruption. For tax administrators, presumptive taxes are an admission of failure. By adopting such a measure, the tax authorities are openly advertising that they are incapable of valuing output, turnover, or of imposing indirect taxes on the targeted activities.

Levying an income tax on agriculture in Ethiopia might be desirable when the country's per capita income rises above several thousand dollars. Few developing countries anywhere have successfully imposed direct taxes on agriculture. The issue is not whether agriculture should "pay its fair share." But, an *income tax* implemented in one year makes no sense.

It would be highly desirable to place the legal, regulatory and supervisory activities of the financial system on a sounder footing. Most countries take well over a decade to make even a modest start in this direction. Ethiopia is likely to have a similar experience.

In principle, the idea of establishing "one-stop investment offices" can enhance efficiency. In practice, few "one-stop" shops have worked. Where they do, as in Mauritius, an "enabling environment" for investment already exists. But, for the rest of Africa, the "one-stop shop" has become one of the dozen or more places that investors must visit as they negotiate (and typically bribe their way) through the bureaucracy in their quest for permission to invest. This is an example of government/donor cooperation gone awry. It is based on the historical fallacy that the creation of new agencies in developing countries will compensate for broader institutional failures. Experience has repeatedly shown that unless the underlying agencies that interfere with investment are reformed, one-stop shops (like other institutional "innovations") will continue to fail.

"Fast-track" adjudication would be a desirable goal in any country, let alone Ethiopia. It cannot be achieved in one year. Furthermore, since contract enforcement (or lack of it) has deep social and political roots, adjudication is not amenable to a bureaucratic "quick fix." Judges might sit longer hours and more courts may be commissioned. These changes, however, will do nothing to overcome the main problem which is the public's lack of confidence in the legal system. Creating that confidence requires a much broader approach than quickening the pace of adjudication.

Finally, reducing population growth has broad-based support among all development specialists. The evidence, however, is now overwhelming, that falling population growth *accompanies* sustained growth and development. The government should focus its efforts on economic reform designed to accelerate development rather than dissipate its efforts on special population control programs.

c. Reforms which are being implemented too slowly

Ideological disputes and turf battles are common to all systems of government. But, unless they are to risk continued retrogression, *reforming* governments *have* to find ways around these constraints so that economic change can be accelerated. Blaming the lack of reform on ideological disputes offers no comfort to a poor country, especially when *all* countries (and their leaders) have the same problem. Countries making these excuses simply reconfirm the criticism that they are not committed to reform. Such a criticism is particularly pointed when applied to a government (as in Ethiopia) that promised radical reform when it took power.

Guided by cross-country experience, there are many areas in the policy matrix where the government in Ethiopia could proceed far more rapidly. Since both "turf" and ideology are involved, these need to be dealt with so that the country as a whole can benefit from faster reform. Some examples include:

- Fiscal deficit and financing: "reduce the overall deficit-to-GDP ratio (excluding grants)" during 1996/97 to 1998/99.
- Financial system: "assess the financial situation of the Commercial Bank of Ethiopia and the feasibility of its restructuring" during 1996/97 to 1998/99
- Pricing and distribution: "eliminate targeted subventions" by December 1998.
- Private sector development: "revise the Investment code to allow private domestic and foreign investment/participation in a number of previously restricted non-strategic sectors..."
- Privatization and public enterprise reform: "speed up the privatization of public enterprises (PEs)" and "reduce the inefficiencies of the PEs" during 1996/97 and 1998/99.

- Agriculture: “gradually phase out market centers as private retailers emerge. Disengage government from direct sales of fertilizer” during 1996/97 and 1998/99
- Agriculture: “progress towards completing privatization of state farms” during 1996/97 and 1998/99.
- Public utilities: “adjust power tariffs to allow for full cost recovery” during 1998/99.
- Exchange system: “establish an inter-bank market for foreign exchange” by 1998/99.
- Exchange system: “phase out export proceeds surrender requirement” during 1996/97 and 1998/99.
- Trade system: “simplify import licensing” during 1996/97.

On the issue of the fiscal deficit, there is no question that the government should begin generating a surplus without further delay. Ethiopia has external debt that it cannot service without large aid inflows. These is no permanent solution to Ethiopia’s debt problem while it continues running a deficit.

Based on financial considerations, there is no rational reason to drag the process of reforming the Commercial Bank of Ethiopia over three years. Delaying reform imposes high, unnecessary costs on the economy. The issue is not whether the government will sell or restructure the CBE. Financial development in Ethiopia will continue to be postponed while local and foreign competition is restrained. Lacking this competition, local asset holders continue to bear the cost of the inefficiency of the CBE. The whole economy is being forced to bear higher transactions costs. As a result, growth is lower than it need be.

To move the budget into surplus, targeted subventions should be dropped. Special anti-poverty measures, where necessary, can be implemented through the donor community and the NGOs. The government (based on its history and lack of resources) has no direct role in such efforts.

Experience elsewhere in Africa suggests that governments hoping to stimulate investment should revise their Investment code to remove all government-induced restrictions on investment. Ethiopia has enough difficulties attracting and retaining (local and foreign) capital without adding further bureaucratic discouragement.

The privatization process could be readily accelerated. Few African governments allowed legal entanglements to prevent them from nationalizing large parts of their economies in the 1960s and 1970s. With similar dispatch, governments could just as readily off-load the state enterprises. The programs could be accelerated if governments would emphasize the employment, income and wealth generating effects of the sale of these enterprises. At present, governments almost exclusively focus on the expected sale proceeds which, under present circumstances, are deflated because the economic situation is so unstable and uncertain.

Based on wide ranging international experience, governments should abandon all attempts to interfere in agricultural production and marketing. The main support for agriculture is to expand infrastructure, promote adaptive research, and facilitate the logistics of disaster relief. There is little to gain and much to lose through continued government involvement in product and input marketing. Such involvement diminishes confidence of all participants (producers, distributors, and wholesalers) and discourages investment in agriculture.

The proposed timetable for privatizing state farms (three years) is too long. The delay will compound the uncertainty in agriculture and hold back the recovery in agricultural production. To facilitate reform in this area, policy makers should be “walked through” an exercise that compares the potential benefits from further delay with the costs.

Public utility rates could be adjusted far more rapidly than proposed. The continuation of SOE losses represents “targeted subventions” in another form. As noted above, reducing the deficit requires the elimination of all subventions. This will prevent the public sector from incurring additional debt that it cannot service.

Evidence from many countries shows that attempts to delay the rationalization of foreign exchange markets can be exceedingly costly. A three-year delay in adopting measures that encourage an “inter-bank exchange market” is counter-productive. Such a market could, and should be established immediately. It would require nothing more than lifting the remaining restrictions on foreign exchange, including surrender requirements for exporters, and allowing all entities in Ethiopia to buy and sell foreign exchange as they please. There is now widespread experience in other countries to show that this can be done.

As shown in other African countries, the basic task is not to simplify import licensing. Import licenses should be eliminated. The most constructive controls over imports by the government are those exercised through an appropriate exchange rate and a well-structured system of tariffs and taxes. Licensing adds arbitrariness, invites corruption, reduces confidence and deters investment. Furthermore, because of corruption, few importers have difficulty evading the licensing requirements if they are so inclined.

d. Overview

The above assessment could be extended readily to the most recently formulated policy action matrixes. Such an exercise would show that the government should seriously reassess its policy commitments. Too many policy changes are currently being attempted. Too few have any chance of success under current capacity constraints. Moreover, some, which could accelerate reforms, are being implemented far too slowly.

Annex B: The Real Exchange Rate in the Franc Zone

The history of the CFA zone has been well covered in other sources.[103] Our focus will be on developments in the aftermath of the devaluation of the CFA from 50 to 100 to the French franc (FF) in January 1994. As shown in Table B.1 and the accompanying graphs, the FCFA franc began to become significantly overvalued in real terms relative to the FF beginning in the late 1970s. (In the table below we report data for the largest economies in the franc zone: Côte d'Ivoire, Senegal, and Cameroon). Relative to the US dollar, the real exchange rate fluctuated in line with shifts in the FF/$ exchange rate. From the mid-1980s (the Louvre Accord), the FCFA appreciated sharply against the dollar.

As expected, the devaluation in January 1994 led to a marked real devaluation against the FF and (initially) the dollar.[104] However, since 1995, the two real exchange rates have moved in opposite directions. For fundamental reform of the performance across the franc zone all bilateral real exchange rates should move in the same direction, i.e., depreciate. But, because the bulk of the franc zone's trade is conducted in dollars,[105] there has been some continued relief. The dominant policy issue, however, is how to reduce the domestic rate of inflation in CFA countries so that it remains lower than inflation in France. This issue takes on special significance with the advent of the *euro*. Continued real appreciation by the FCFA against the *euro* will be unsustainable.

With a long history of sluggish income growth, chronic imbalances between exports and imports, and rising levels of foreign debt, the basic challenge for the franc zone as a whole since the 1994 devaluation has been to ensure that the real exchange rate does not once more become massively overvalued. This will require franc zone governments to avoid repeating the pre-devaluation mistakes. Has this happened? At one level, it has not. The franc zone retains a fixed exchange rate with a commitment to keep inflation under control. These conditions prevailed prior to the devaluation, yet they could not be sustained. At another level, however, there is now major interest among policy makers on how the franc zone countries might adapt to the introduction of the *euro*. This has helped focus the attention of policy makers on exchange rate dynamics.

Some progress is evident in the macroeconomic data. As shown in Table B.1, franc zone countries are noticeably more fiscally conservative than prior to the devaluation. Nonetheless, the countries are still running budget deficits. Furthermore, as a group, the countries have been systematically reducing, though not eliminating their balance of payments deficits. For the present, the situation appears to be manageable although it is unclear how the massive external debt will be rationalized. It is also unclear how Senegal and other franc zone countries will reduce their chronic dependence on foreign aid.

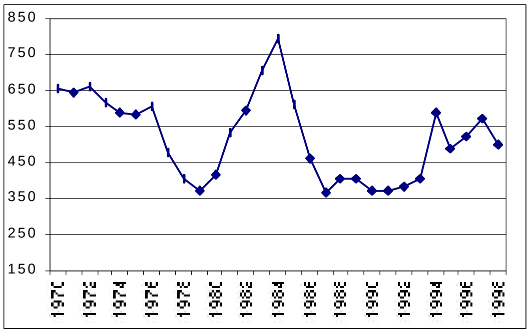
Annex B. Table 1. Real Exchange Rates: Côte d'Ivoire, Cameroon and Senegal

Year	Ex. Rate	Ex. Rate	France CPI	USA PPI	Côte d'Ivoire CPI	Côte d'Ivoire Real Ex. Rate (to FF)	Côte d'Ivoire Real Ex. Rate (to USD)	Cameroon CPI	Cameroon Real Ex. Rate (to FF)	Cameroon Real Ex. Rate (to USD)	Senegal CPI	Senegal Real Ex. Rate (to FF)	Senegal Real Ex. Rate (to USD)
	CFA Francs (per USD, eop)	CFA Zone (eop)	(1995=100)	(1995=100)	(1995=100)			(1995=100)			(1995=100)		
1970	276.0	50.0	19.37	29.55	12.39	78.2	658.3	11.26	86.0	724.4	15.57	62.2	523.9
1971	261.2	50.0	20.42	30.54	12.34	82.7	646.5	11.71	87.2	681.3	16.17	63.1	493.4
1972	256.1	50.0	21.66	31.88	12.37	87.6	659.9	12.66	85.5	644.8	17.17	63.1	475.4
1973	235.4	50.0	23.25	36.07	13.75	84.5	617.6	13.97	83.2	607.9	19.10	60.9	444.6
1974	222.2	50.0	26.43	42.86	16.14	81.9	590.1	16.38	80.7	581.5	22.27	59.3	427.7
1975	224.3	50.0	29.52	46.82	17.98	82.1	584.0	18.60	79.4	564.6	29.33	50.3	358.0
1976	248.5	50.0	32.36	49.00	20.15	80.3	604.3	20.45	79.1	595.4	29.64	54.6	410.8
1977	235.3	50.0	35.43	52.00	25.68	69.0	476.4	23.45	75.5	521.7	33.00	53.7	370.7
1978	209.0	50.0	38.71	56.05	29.08	66.6	402.8	26.38	73.4	444.1	34.13	56.7	343.2
1979	201.0	50.0	42.83	63.07	33.83	63.3	374.7	28.11	76.2	451.0	37.43	57.2	338.7
1980	225.8	50.0	48.63	71.98	38.81	62.7	418.8	30.80	78.9	527.7	40.70	59.7	399.3
1981	287.4	50.0	55.11	78.56	42.22	65.3	534.8	34.10	80.8	662.1	43.10	63.9	523.9
1982	336.3	50.0	61.71	80.14	45.42	67.9	593.3	38.62	79.9	697.7	50.59	61.0	532.7
1983	417.4	50.0	67.55	81.14	47.99	70.4	705.7	45.05	75.0	751.7	56.47	59.8	599.7
1984	479.6	50.0	72.73	83.08	50.04	72.7	796.3	50.17	72.5	794.2	63.12	57.6	631.3
1985	378.1	50.0	76.98	82.68	50.97	75.5	613.2	54.44	70.7	574.2	71.33	54.0	438.2
1986	322.8	50.0	78.93	80.29	55.91	70.6	463.5	58.67	67.3	441.7	75.74	52.1	342.1
1987	267.0	50.0	81.53	82.41	59.79	68.2	368.0	66.38	61.4	331.5	72.60	56.2	303.1
1988	303.0	50.0	83.73	85.72	63.94	65.5	406.1	67.50	62.0	384.7	71.28	58.7	364.3
1989	289.4	50.0	86.66	89.97	64.61	67.1	403.0	66.37	65.3	392.3	71.60	60.5	363.6
1990	256.5	50.0	89.58	93.17	64.09	69.9	372.8	67.10	66.8	356.1	71.83	62.4	332.6
1991	259.0	50.0	92.47	93.38	65.17	70.9	371.1	67.14	68.9	360.2	70.57	65.5	342.7
1992	275.3	50.0	94.65	93.91	67.92	69.7	380.7	67.13	70.5	385.2	70.49	67.1	366.8
1993	294.8	50.0	96.65	95.31	69.39	69.6	404.9	64.98	74.4	432.4	70.08	69.0	400.9
1994	534.6	100.0	98.25	96.52	87.49	112.3	589.8	87.78	111.9	587.8	92.71	106.0	556.6
1995	490.0	100.0	100	100	100	100.0	490.0	100	100.0	490.0	100	100.0	490.0
1996	523.7	100.0	102.01	102.28	102.48	99.5	522.7	104.67	97.5	511.7	102.75	99.3	521.3
1997	598.8	100.0	103.23	102.26	106.60	96.8	574.4	105.77	97.6	578.9	104.56	98.7	585.6
1998	562.2	100.0	103.93	99.73	111.60	93.1	502.4	105.87	98.2	529.6	105.77	98.3	530.1

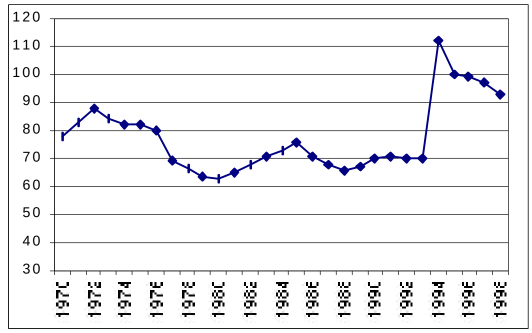
Source: International Financial Statistics, IMF 2000

Côte d'Ivoire

Real Exchange Rate (to the French Franc)

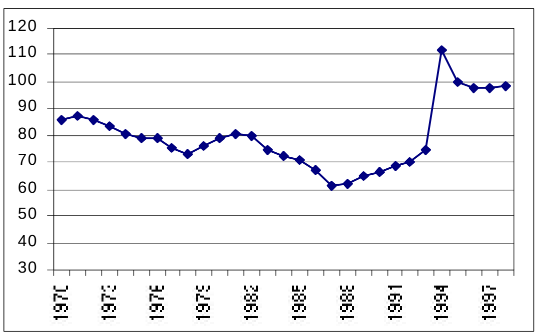


Real Exchange Rate (to the US Dollar)

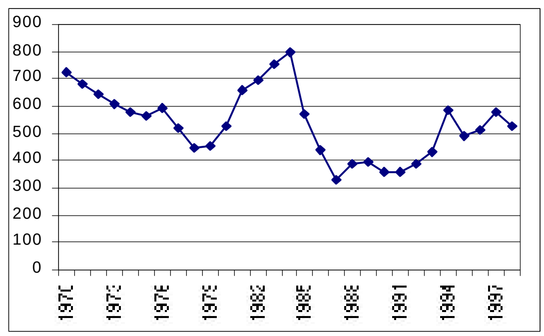


Cameroon

Real Exchange Rate (to the French Franc)

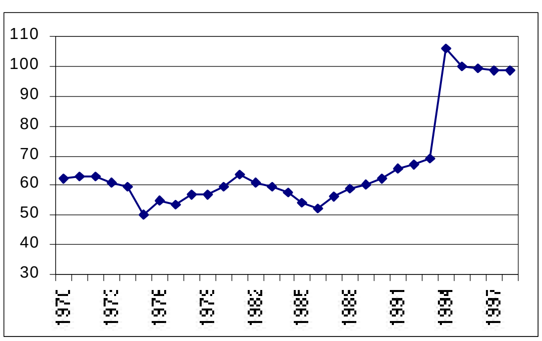


Real Exchange Rate (to the US Dollar)

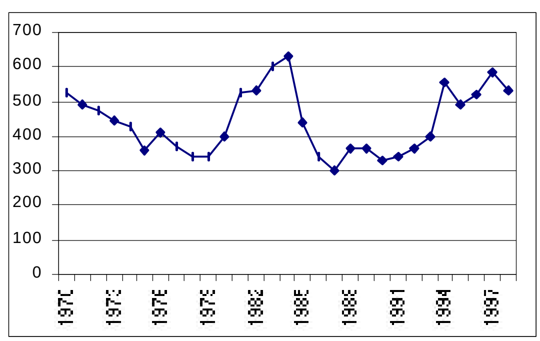


Senegal

Real Exchange Rate (to the French Franc)



Real Exchange Rate (to the US Dollar)



An important advantage of a fixed exchange rate is that it enhances credibility (and reputation) of the various authorities.[106] After having kept the exchange rate fixed from 1948 to 1994 no one doubts the doggedness of the franc zone governments. Many, however, doubt their wisdom. The purported benefits of a fixed nominal exchange rate have come at a high cost in terms of lost growth and insupportable levels of official debt. For the future, the basic question is whether the franc zone countries will staunchly resist devaluation as the real exchange rate appreciates. This is the essence of the credibility problem they face.

Seen over a longer time period, it is unlikely that a fixed CFA can be sustained. There are a number of considerations.

First, given the continued debt overhang in the francophone countries and the distortions created by 46 years of a fixed nominal exchange rate, the 50 percent devaluation was significantly less than the amount required to re-establish macroeconomic balance. The franc zone is now more than five years into the devaluation and no CFA country is on a path through which macroeconomic balance will be restored.[107]

Second, rising costs in the CFA countries relative to France and other European countries have eroded a significant amount of the real devaluation of 1994. This slippage already appears to be having adverse dynamic effects evident in the persistence of a substantial balance of payments deficit.

Third, the CFA countries are not pursuing the other measures (such as privatization, government retrenchment, and civil service reform) with the vigor required to ensure that the fixed exchange rate system will endure. It is especially noteworthy that no CFA zone country has an explicit program to reduce its dependence on foreign aid. The assumption seems to be that foreign aid will continue. However, if aid flows decline, pressure on the exchange rate will increase.

Fourth, now that the FCFA has been devalued, it is unclear how much the financial markets will indulge the franc zone governments as pressure on the FCFA mounts. Prior to the 1994 devaluation and, indeed, prior to the start of the European monetary union, all creditors understood that France would guarantee the convertibility of the CFA. The status of that guarantee is unclear now that France's fiscal and monetary policies are determined by circumstances in the European Union as a whole.

What next? In the past, a number of mechanisms were tried to induce a real devaluation without having to adjust the nominal exchange rate. None has worked. The most spectacular failure was the attempt to reduce public sector wages in Côte d'Ivoire. This was reversed under pressure from the unions. Another has been a system of "uniform tariff-cum-subsidies" designed to simulate devaluation.[108] This approach requires a country to purposefully distort its tax and expenditure systems in ways that create more extensive inefficiencies than the general tax on economic activity associated with an overvalued real exchange rate.

A third approach has been the use of a “dual exchange rate system” which attempts (in ways that mimic the so-called “Tobin tax”) to make the movement of financial capital less attractive. The argument is that with a lower volume of financial flows, the pressure on the FCFA would be less intense and therefore easier to resist. The problem with this proposal is that it is only one side of the relationship. As capital flows diminish, real economic activity declines. Thus, the dual exchange rate system has the effect of distorting basic pricing relationships and of curtailing real economic activity.

All of these approaches have the drawback of creating incentives for evasion. They also involve the use of specific distortions on trade and exchange relations to overcome (or offset) the distortions that arise when the various governments are unwilling to pursue a sustainable exchange rate policy. Based on the general theory of second best, economists understand that a Pareto improvement may be achieved by such actions. Second best theory, however, presumes that the Pareto-improving action is unattainable. This is not the case in the franc zone since economic efficiency can be improved by floating the FCFA.

This is where the link between *sustainable* trade and exchange reform and the real exchange rate arises. For the franc zone, the conclusion is straightforward: sustained trade and exchange rate reform is impossible while the fixed nominal exchange rate leads to persistent overvaluation of the real exchange rate. Of greater relevance, however, is the process by which policy makers in the franc zone appear to have convinced themselves that a fixed exchange rate can be sustained as the global economy evolves. Since all major world currencies are floating -- including the French Franc and the *euro* -- persistent real overvaluation of the FCFA remains inevitable so long as it, too, does not float.[109]

Annex C: Sequencing of Policy Reforms

Over the last decade and a half, concerns for the "sequencing" of policy reforms have become (among other things) institutionalized means of delaying particular aspects of economic reform. "Sequencing" is a matter of degree, not kind. All policies have to be "sequenced" or "phased" to some extent. The attempt to change all policies at the same time is an invitation to confusion and failure. (Even "big bang" changes are selective.) The quantitative impact of some policy changes is more significant and immediate. For instance, it is far more important for economic stability to reduce the budget deficit than to reform the legal system even though, in the long term, the latter may be more fundamental for growth and development.

Nonetheless, much effort has been dissipated by policy makers convinced that there is some "optimal" or "right" way to sequence economic reforms. The idea has come from a relatively large literature that is long on rhetoric and short on empirical content (McKinnon 1982, 1991; Edwards 1984, 1986, 1994; Bruno 1985). For example, it has been widely argued that an economy has to be stabilized *before* structural adjustment is attempted (McKinnon 1982; Edwards 1984; Roemer and Radelet 1991). Proponents of this view, however, miss the point that other countries have done the opposite. Russia is an obvious case (*Economist* 1995; *Financial Times*, April 1997). Despite its present troubles, the Russian economy has been moving towards greater economic stability largely because it has undergone profound structural change. Proponents of sequencing have drawn heavily on the experience of the Southern Cone countries to argue that successful trade and exchange rate reforms require the step-wise movement from measures to open up the current account followed, significantly later, by the opening of the capital account (McKinnon 1982, 1991; Edwards 1984, 1986, 1992, 1994; Bruno 1988). There are two problems with this view. It seriously misinterprets the Southern Cone experience (de la Cuadra and Hachette 1988). And, it misrepresents what has occurred elsewhere (McPherson 1995). As an illustration, Indonesia opened its capital account in 1970 with positive effects. Singapore did the same a couple of years later. The Gambia removed all controls on trade and exchange with no attention to sequencing. The results were also positive (McPherson and Radelet 1995).

None of these points would matter if the musings of development specialists remained between the covers of academic journals. Unfortunately, the sequencing of reforms, particularly the question of "optimal" sequencing, became a buzz word in the donor community. Accordingly, the issue has been raised regularly in discussions between the donors and African governments.[110]

These arguments have had three adverse effects. First, concerns about "sequencing" have diverted attention from the more important question of *sustaining* policy reform once the changes are made. Second, policy makers reluctant to reform have been able to use the "need" for sequencing as an institutionally acceptable excuse for delaying much needed policy changes. And third, the argument that there is an "optimal" or even "sub-optimal" sequence of economic reforms is simply wrong.

As noted in Annex A, policy makers typically face "reform overload." Most policy reforms that are not "stroke-of-the-pen" changes. Budget reform, tax reform, legal and regulatory reform, cannot be achieved over the short term. Their implementation, however, requires specific capacities, many of which are scarce. Proponents of the need for optimal, or even appropriate, sequencing effectively are arguing that scarce capacity be devoted to ensure that particular rigidities are retained. For example, those who argue that the capital account has to be opened only after the current account would require scarce capacity to be devoted to the continuation of capital controls in order to enable other elements of trade and exchange rate reform to be "properly" sequenced. For African governments struggling to implement and remain focused on economic reform, retaining such controls is counter-productive. Capital controls have not worked efficiently, fairly or effectively anywhere in Africa. Those who advocate this type of sequencing are simply prolonging inefficiencies that undermine growth and development.

Policy makers who are reluctant to reform welcome excuses that appear to legitimize their reluctance. In this respect, the sequencing argument has been a perfect foil. Under the guise of what appears to be a valid theory of optimal behavior, policy makers have been able to postpone economic reform. As already noted, limits on implementation capacity impose some phasing on the reforms. These limits, however, have nothing to do with the deflection of reforms for which implementation capacity is available.

The weakest aspect of the sequencing literature is that it lacks a theoretical foundation (Strotz 1956; Lucas 1976). In theory no pre-determined sequence of economic decisions can remain "optimal" or even "appropriate" as new information emerges *and* structural change occurs. Since reform is undertaken in order to change the structure of an economy, no "optimal" sequence (which, of necessity, has to be derived from the structure of the economy in the base period) can be determined in advance.[111] Proponents of sequencing have missed this crucial point.

None of the above arguments will dissuade officials who are intent on attempting to "phase" their reforms in an "optimal" way. However, it is important for policy makers to recognize that many feasible reform paths exist.[112] For Africa, the problem of moving economies forward has not been how the reforms are phased. Rather, the basic problem has been a general lack of persistence once the policy changes are made. This is not an issue about which the "optimal" sequencing literature has any thing useful to say.

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Endnotes

[1] Members of the franc zone have not adopted market-based exchange rates. So far, they have adjusted by a single devaluation (January 1994) reinforced with several non-market restraints. (See Annex B.)

[2] *African Development Indicators* 1998/99, Sections 5,6,8. The improvements are not uniform across countries. Some countries, e.g., Congo-Kinshasa and Sierra Leone, have collapsed. For many countries the improvements have been tangible and significant (United Nations 1996a; Madavo and Sarbib 1997; Sweden, Government of 1998).

[3] The World Bank has several detailed studies World Bank (1981, 1984, 1986, 1989, 1994). These add to a rich literature which includes OAU (1979, 1980), Mazrui (1980), Lele (1981, 1989), Roemer (1982), ODI (1982;1992), Hyden (1983, 1990), Morss (1984), McNamara (1985), Brown and Wolf (1985), United Nations (1986), Lamb (1987), Obasonjo (1987), Sandbrook (1986, 1987, 1996), Gakou (1987), Harrison (1987), Iliffe (1987), Mabogunje (1987), Elkan (1988), Klitgaard (1988, 1990), Abernathy (1989), Serageldin (1989), Ward (1989), Parfitt and Riley (1989), Commins (1989), World Bank/UNDP (1989), ECA/OAU (1989), Nyang'oro (1989), Ravenhill (1990), Herbst (1990), Brent (1990), Callaghy (1990), de Rosa (1991), Svedberg (1991), McPherson and Zinnes (1991), Rimmer (1991), Frimpong-Ansah (1991), WINROCK (1991, 1993), Frimpong-Ansah, Kabur and Svedberg (1991), Gallagher (1991), Collier (1991, 1994), Eicher and Baker (1992), Summers (1992), Lavy (1992), Ayittey (1992, 1998), Hyden and Bratton (1992), Harsch (1993), Ghura and Grennes (1993), Easterly and Schmidt-Hebbel (1993), Nash (1993), USAID (1993), Larsson (1994), Bouton, Jones and Kiguel (1994), *Economist* (March 1994), Cornia and Helleiner (1994), Widner (1994), Schatz (1994), Sahn (1994), Sachs (1994), Collier and Gunning (1994; 1999), van Druen and van der Kraaij (1994), CDR (1995), Berthelemy (1995), Easterly and Levine (1995), OXFAM (1995), Ndulo, van de Walle.(1996), Schmidt-Hebbel (1996), Demery and Squire (1996), Stern and Gugerty (1996), Odedokun (1996), Lensink (1996), Gyimah and van de Walle (1996), IRIS (1996), van de Walle (1996), Sachs (1996), Thomas (1996), Goldsbrough *et al.* (1996); Ghura and Hadjimichael (1996), USDC (1997); Sachs and Warner (1997), Stryker (1997), Bennell (1997), Goldberg (1997), HIID (1997), Rodrik (1998), Kose and Reizman (1998), Sweden, Government of (1998), Block (1998), Freeman and Lindauer (1999), Barrett and Carter (1999), Gray and McPherson (1999).

[4] This was reconfirmed by the Governor of the Reserve Bank of South Africa, Dr. C. Stals, at a seminar at HIID in May 1997 (Stals 1997). He explained that South Africa would only remove exchange controls "gradually". Rapid removal of those controls, he stated, would lead to capital flight.

[5] This amount of gross foreign assistance was equivalent to 27 percent of GDP (*Macroeconomic Indicators*, Ministry of Finance and Economic Development, Lusaka, various issues).

[6] The World Bank's mission to Zambia in March 1999 to help prepare a "Comprehensive Development Framework" provided information showing that in PPP terms Zambia's per capita income had declined by 41.8 percent per annum between 1988 and 1996. The severity of the decline led President Chiluba during the opening of Parliament (21 January 1999) to apologize to the Zambian people for the government's inability to improve their circumstances.

[7] See IMF 1999. The commitment to achieve middle-income status was made as part of the Vision 2020 exercise. Based on 1996 income levels and standards for middle-income status, achieving this goal would have required Ghana to grow at a rate in excess of 4 percent per capita per annum until 2020. After that point, the country would have to continue growing at 2 percent per capita per annum in order to retain middle-income status. Based on historical and current growth performance, Ghana is not likely to meet this goal.

[8] A well-known example in Africa is the exchange rate auction introduced in Zambia in October 1985. During its initial stages there was a sharp depreciation of the exchange rate reflecting the pressures on the exchange rate from pent-up demand, the debt overhang, and the lack of fiscal discipline. (The budget deficit in 1986 approached 26 percent of GDP.) Instead of making the appropriate changes to manage the economy effectively, the Zambian government abandoned the auction and re-fixed the kwacha at a rate that was "acceptable" to senior officials (Bates and Collier 1993). This policy reversal did nothing to improve Zambia's economic situation. The downward spiral continued (Lewis and McPherson 1994; Hill and McPherson forthcoming).

[9] Interest group dynamics have been examined in Bates and Kreuger (1993).

[10] These groups will (typically) begin by taking defensive measures (such as shifting capital abroad, disguising income to evade taxes, and creating 'shell' companies) so that the impact of future attempts to make such changes will be minimized.

[11] Zambia found itself in this position in July 1995. Unable to make a credible case that expenditures could be cut, Zambian officials were forced to reverse earlier trade tax reform to cover a K70 billion (roughly 3 percent of GDP) fiscal "slippage." The IMF insisted on this demonstration of "resolve" as a condition for continuing with its Rights Accumulation Program. Tariff rates and excise duties that had been lowered earlier in 1995 as part of a long-term effort to reform the tax system were raised (Hill 1999).

[12] The United States is an example. John Kenneth Galbraith once (wryly) noted that "Americans do not like paying taxes with or without representation." Presidential candidate Walter Mondale doomed his chances of being elected in 1984 by stating that he would raise taxes so as to reduce the budget deficit. Several years later, George Bush contributed to his election defeat in 1992 by reneging on his pledge: "Read my lips: no new taxes" .

[13] *Economist* (5 March 1994) refers to the OXFAM critique of the World Bank. See also OXFAM (1995).

[14] The World Bank itself has been distancing itself from the "Washington consensus." Indeed, Stiglitz (1998) criticizes its narrow agenda. Both Stiglitz and Wolfehnson (1998) called for a "new approach" to development. However, based on Stiglitz's description of what is involved, no African country has the capacity to implement such an approach. In effect, African countries that sign on to the "new approach", once more, will be pre-programming non-compliance and policy reversals.

[15] One well-worn approach is for a government to agree to the overall fiscal objectives set by the IMF (specifically a deficit target) and begin taking steps in this direction. Once the program has the IMF Board's approval, senior government officials begin suggesting to IMF staff that some "difficulties" have arisen. The list of excuses has become routine: the harvest is worse than anticipated (when the rains were light); the rain did more damage than expected (when heavy); foreign prices have moved adversely (or not favorably enough); or unanticipated bottlenecks in transport or factor supply have arisen. While the details of the approach may vary, the basic problem is that the government is not willing to meet the conditions as originally negotiated. Almost invariably, this is known in advance.

[16] This point is evident in Stiglitz (1998) where he described a "new approach" to the "transformation of society". Essential to this view of development is "participation" and "ownership" by those being "transformed." However, Stiglitz fails to describe how the donor community, especially the World Bank, would transform its activities to induce such ownership or participation. This flaw dooms the whole approach.

[17] This is not always the case. Tariff reform in Zambia provides a counter example. The minister of finance pushed hard for reductions in tax rates, a broad tax base, and the elimination of special exemptions. Such reforms were introduced and approved in the 1995 budget. Only then did the nature of the game emerge. Within months, the minister (whose official position gave him the relevant discretion) had approved more than 100 Statutory Instruments to exempt specific firms and activities from the reforms. This action undercut the reforms. Recipients of the benefits were widely reported to have expressed their gratitude to the ministers in the usual manner.

[18] Rodrik (1998) reached the same conclusion with respect to trade reforms.

[19] Macadamia nut production in Malawi is an example. Cashews in Zambia is another.

[20] The importance of the indirect effects of policy reform has been a common theme in the agricultural literature. Agricultural economists realized that their best efforts at the project level were frequently undercut by inappropriate macroeconomic policies (Timmer, Falcon, and Pearson 1983; Tomich, Kilby and Johnston 1995; Schiff and Valdes

1998).

[21] According to the IMF's classification of exchange rate regimes (*International Financial Statistics* March 1999, p.8), the majority of African countries outside the franc zone have "independently floating" exchange rates. Reality, of course, is otherwise. Most exchange rates across Africa are manipulated to some degree. A recent example was the Zambian Minister of Finance's attack on businessmen for pricing their products in U.S. dollars. According to the Minister, businesses were "stealing from customers" by pricing their goods and services this way (*Zambia Daily Mail* 15 May, 1999, page 1). Officially, at least, Zambia fully liberalized its exchange regime in January 1994.

[22] Since mid-1995, the Bank of Zambia has "managed" the exchange rate in an attempt to contain inflation. The basic problem has been a high growth rate of reserve money due to a persistent budget deficit. The ensuing overvaluation of the real exchange rate has undermined growth (Hill and McPherson 1998; McPherson and Rakovski 1999).

[23] Frenkel and Mussa 1985; Khan and Lizondo 1987; Dervis and Petri 1987; IMF 1987; Balassa 1988; Moran 1988; Bruno 1988; Laird and Nogues 1989; van Wijnbergen 1989; de Rosa 1989; Edwards 1989; Srinivasan 1991; Ghura and Grennes 1993; Edwards 1993; Killick 1993; Rouis, Razzak, and Mollinedo 1994; Hill 1994; Taylor 1996; Engel 1996; Agenor and Montiel 1996; Asea and Reinhart 1996; Duesenberry *et al.* 1996;United Nations 1996, Pt.III; Obstfeld and Rogoff 1997; Stryker 1997; Ul Hague, Mathiesson, and Sharma 1997; Krueger 1997; Block 1998; Fischer, Hernandez-Cata, and Khan 1998; Kose and Reizman 1998

[24] Since price changes in most developed countries are similar, movements in nominal exchange rates closely approximate changes in real exchange rates.

[25] The senior African officials who assembled in Washington in March of 1999 at the invitation of the U.S. Government to follow up on President Clinton's initiatives on Africa focused primarily on aid and debt. Discussions of the impact real exchange rates, both explicit and implied, did not occur. Ultimately, trends in these variables will be more important for Africa's growth and development.

[26] Ahamed 1986; Dervis and Petri 1987; Caballero and Corbo 1989; Reisen 1989; Edwards and van Wijnbergen 1989; Dornbusch 1990; Roemer and Radelet 1991; Summers 1992; Easterly and Schmidt-Hebbel 1993; Larsson 1994; Bruno 1994; World Bank 1994; Clement 1995; Rodrik 1995; Engel 1996; Lensink 1996; Ghura and Hadjimichael 1996; Schmidt-Hebbel 1996; Goldsbrough *et al.*1996.

[27] The renewed fighting in Angola, civil war in the Congo, and the border war between Eritrea and Ethiopia suggest that Africa is far from political and economic stability.

[28] Nigeria illustrates the potential response. Beginning in the mid-1980s, its leaders dismantled the state-controlled marketing boards. Stimulated by improved infrastructure, this led to broad-based increases in production. To illustrate, the crop production index (1989-91=100) was 52 in 1980. In 1987 it was 71 and 136 in 1996 (*Agricultural Development Indicators* 1998/99, Table 8.9).

[29] Grilli and Yang (1988) reviewed the terms of trade data. Their data showed that the adverse price trends continued until the mid-1980s. By contrast, there had been favorable movements in the income terms of trade for primary producers. Parenthetically, it is worth noting that the apparent terms-of-trade decline continues to be overstated. Grilli and Young, like almost all previous efforts – Sproas (1980) is an example – ignore the fact that (by construction) any base-weighted terms-of-trade index has a (significant) downward bias.

[30] Deane (1965) emphasized how rising agricultural output had provided a solid foundation for the United Kingdom's "industrial revolution". Agriculture, as well as industry, experienced a "revolution."

[31] Recent discussion of agricultural development in Africa have begun to emphasize the various intersectoral "growth linkages" (Delgado *et al.* 1998; GCA 1999).

[32] Direct African experience is reported in McPherson and Radelet (1995) where a sharp improvement in agricultural incomes and *entrepot* activity in The Gambia created a lobby that supported economic reform.

[34]. Chhibber (1988) reported relatively low price and supply responses for African agriculture. Recent work by Delgado *et al.* (1998) explains this in terms of the constraints facing agriculture. When these constraints have been eased through liberalization, the direct and indirect income and employment responses are high.

[34] This is not a new theme. The earliest work on economic development stressed the importance of raising levels of efficiency (Nurkse 1953; Finer 1954; Brozen 1954; Chenery 1958; Kuznets 1966).

[35] Kelley (1991) provides details for Zambia. The debate between Psacharopoulos (1994) and Bennell (1996) over the size of the relative returns to education in Africa illustrate that returns seem to be low across the continent. The effects of the spread of HIV/AIDS (discussed below) adds a further adverse dimension.

[36] Botswana has made that commitment. A large part of the government budget (more than 40 percent) is devoted to education and health (BIDPA 1999).

[37] *World Development Report* 1998 "Knowledge for Development". The *Africa Development Report* (ADB 1998) has a similar focus.

[38] This was a recurrent theme at the Winhoek meetings of the World Economic Forum in May 1998. However, many senior African officials argued that even though their countries have taken all of the measures to promote reform they were seeing little in the way of positive response from foreign investors. Based on Africa's history of instability, their expectations of the potential response have been wildly unrealistic. FDI does not simply materialize just because policy makers decide they would like to move on from years of state intervention, arbitrary economic policy, and macroeconomic mismanagement. The Asian experience is crucial here. FDI first came as a trickle largely through the (tentative) repatriation of flight capital by local businessmen and women. Foreigners typically became involved (also tentatively at first) through local partnerships that offered some protection from disruptive elements.

[39] The point was illustrated in Zambia where in a series of actions, dramatized by four speeches over the period 1968 to 1975, President Kaunda nationalized most of the major economic enterprises in the country. At the time, nationalization had widespread political support. It has been instrumental in Zambia's economic ruin. After twenty-five years of government domination of economic activity, Zambia's real per capita income is now roughly 35 percent of what it was in 1975 and foreign debt per capita (relative to national income) is one of the highest in the world.

[40] Net foreign aid to Africa (excluding Nigeria and South Africa) was 6.5 percent of GDP in 1980 and 9.8 percent of GDP in 1996 (*African Development Indicators* 1998/99). Gross flows were significantly more than double net flows. Both Nigeria and South Africa receive minimal amounts of aid.

[41] Sources are *World Development Indicators* 1998 CD-ROM and *African Development Indicators* 1998/99.

[42] Efficiency wage theories link wages to nutrition, motivation, and improved productivity.

[43] Ironically, developed countries have been far more successful cutting wages and benefits to promote adjustment than poor countries. In the United States, for example, many industries (particularly the airlines and automobiles) have restructured through "wage give-backs." The Netherlands has adjusted to the over-valued guilder (and mark) through a more generalized process of wage compression.

[44] In the UK, Prime Minister Margaret Thatcher faced down the coal mineworkers. In the US, President Ronald Reagan fired the air traffic controllers who were members of the PATCO union. And, in Australia, Prime Minister Bob Hawke refused to support union protests over a lockout by a mine owner in Western Australia. All these actions were a major break with the "normal" practice of government accommodation to union demands. The hard line taken by all three leaders helped moderate wage increases providing the basis for extended periods of sustained economic growth.

[45] The conclusions reached by these authors have been recently confirmed by the Reserve Bank of South Africa (Stals 1998).

[46] The ideas were clearly stated (Smith 1789, Skinner edn. 1979):

> The greatest improvement in the productive powers of labour, and the greater part of the skill, dexterity, and judgement with which it is anywhere directed, or applied, seem to have been the effects of the division of labour (p.109).
>
> This division of labour, from which so many advantages are derived, is not originally the effect of any human wisdom, which foresees and intends that general opulence to which it gives occasion. It is the necessary, though very slow and gradual consequence of a certain propensity in human nature which has in view no such extensive utility: the propensity to truck, barter, and exchange one thing for another (p.117).
>
> As it is the power of exchanging that gives occasion to the division of labour, so the extent of this division must always be limited by the extent of that power, or, in other words, by the extent of the market (p.121).

[47] Over the period 1980-1989, real per capita income in Africa declined by 0.6 percent per annum. It continued to decline from 1990 to 1994. It has since recovered by 7 percent (*IMF World Economic Outlook* October 1998: Table 5, Statistical Appendix; *African Development Indicators* 1998/1999).

[48] These data show reduced production of some of the higher valued crops (maize and sorghum) combined with significant increases in the output of plantains, yams, cassava, and sweet potato.

[49] The former is consistent with Engels law, the latter with Bennet's law. Engels law holds that the income elasticity of demand for food is less than one. Bennet's law holds that the income elasticity of calories (or food energy) is less than one. Africa's experience is consistent with both laws. The decline in real per capita income has led to an increase in the share of expenditure on food and a rise in the consumption of lower quality food products (measured by calorie content).

[50] The rise in the income share of agriculture is contrary to the normal "patterns of growth" (Chenery and Syrquin 1975; Syrquin 1989; Syrquin and Chenery 1989). This is one of the several dimensions of retrogression across Africa (McPherson and Zinnes 1992).

[51] Input-output analysis highlights the income and employment effects that arise when inter-regional linkages are strengthened. Leontief (1966:65), for example, noted that "Economic systems tend naturally to combine the international division of labor with the minimization of transport costs".

[52] None of literature on "patterns of growth" identified distance or geographical location as a disadvantage (Chenery and Syrquin 1975, Syrquin and Chenery 1989). Moreover, there is nothing in Kuznets' (1966) study of "modern economic growth" to suggest that geography and distance were major impediments.

[53] Sachs has been highly critical of what he sees as the failure of growth theorists to consider the development problems associated with geographical isolation, tropical climate and distance (Sachs and Warner 1995; Sachs 1996, 1997; Bloom and Sachs 1998). This, however, represents a narrow view of the literature. Significant theoretical and practical work on location and distance appeared in the 1940s and 1950s (Hitchcock 1941; Isard 1951a,b; 1952; Schultz 1957).

[54] Deane (1965:Ch.5) argued that one of Britain's main advantages during the early years of the industrial revolution was its transport system. This contrasted with the transport difficulties elsewhere and the special efforts made to deal with them (Heilbroner 1953; Halperin and Dow 1977; Pt II; Kennedy 1987:16ff.).

[55] A persistent theme in studies of Cecil Rhodes (Rotberg 1988; Thomas 1997) was his single-minded commitment to

the expansion of the transport infrastructure. He was convinced that logistics were essential to wealth creation. This is why, for Africa at least, transport (rail, road, lake) absorbed such a large part of the initial investment (Frankel 1938). It is also why the economic performance of many countries has depended so heavily on the efficiency of the transport infrastructure. Baldwin (1966) provided a detailed account of the opportunities created in Northern Rhodesia/Zambia when the railroad expanded and the problems that arose when, following WWII, the rail system deteriorated due to lack of investment.

[56] Among the agricultural economists who emphasized the economic importance of distance and space are Fisher (1954:25-29), Schultz (1957), Dumont (1957), Bressler (1958), Pentzer (1959), Hunter, Bunting, and Bottrall (1976:Pt.III), McPherson (1982;1983), ICRISAT (1985:Pt.III), and Eicher and Baker (1992). All of these sources provide many other references.

[57] This point was made in the context of FDI above. It is a recurring theme in discussions of Africa (*cf. Financial Times* March 21, 1999:34-37).

[58]. The discussion by Keynes (1936: Preface, ch.12) of expectations emphasizes the value of liquidity when conditions are uncertain. "Going liquid" is a common way of keeping options open.

[59] Based on discussions by the authors with senior Zambian policy makers in March 1997.

[60] Hill and McPherson (1998) provide a framework for thinking about helping move Zambia forward. McPherson (1999a) continues that effort.

[61] See Friedman (1958). He argued that foreign aid favors public sector activity at the expense of private activity. As such, it directly undercuts the (private sector) activities that are the principal source of sustained growth and development.

[62] Macroeconomic managers and policy makers are increasingly seeing the "temporary" reintroduction of capital controls (as in Malaysia) as a means of coping with extreme pressure on the financial system. Radelet (1999) suggested this possibility for an economy whose private debtors are having problems servicing their external debt. For Africa, such an approach would be regressive. It (a) underestimates the ability of local operators to circumvent the controls; (b) overestimates the honesty and fairness of those who would administer the exchange control; and (c) minimizes the adverse expectations that the reintroduction of exchange controls would create.

[63] An important feature of "enhanced capacity" is improvement in the availability and timeliness of key macro-economic data. Experience shows that many policy makers are "flying blind" because they have few data on which to base their decisions. More often the data they have are out of date (Duesenberry and McPherson 1991, 1992; McPherson and Radelet 1995; Duesenberry, Goldsmith and McPherson 1999). Such circumstances can lead to reversals because policy makers do not have timely information that would allow them to keep the economy on track.

[64] The political economy of adjustment illustrates why the costs of change have been emphasized rather than the costs of not changing (Lal 1987; Herbst 1990; Callaghy 1990; Nelson 1990; Haggard and Kaufman 1992; Widner 1994; Rodrik 1996). Politicians and lobbyists have been able to make far more "mileage" out of the immediate disadvantages experienced by particular groups rather than the general (but delayed) improvement for the whole economy.

[65] Most senior policy makers do not think in terms of *effective* rates of protection. To make their point, policy analysts would need to construct some examples that illustrate the concept, particularly why direct changes (such as raising tariffs) have so many important indirect effects (through the protection of value-added).

[66] The committee consisted of all the economic ministers and heads of the principal state-owned enterprises. It met on a weekly basis to review the progress of the economic reform program.

[67] Problems arose as other members of the Cabinet began to see the Committee as usurping some of their influence.

[68] Some governments have consciously used market mechanisms to limit their policy options. Indonesia, for example, fully opened its capital account on the balance of payments in 1970. The intention was to ensure that internal economic policies remained consistent with external balance. This approach worked well. The recent difficulties in Indonesia reflect other policy weaknesses, principally the failure to ensure that the key financial institutions maintained appropriate standards in their borrowing and lending (Gillis 1998).

[69] The present international monetary system provides a paradox that too many analysts pass by. Developed countries, all of which have deep, highly structured and well-supervised financial systems, float their currencies. Many developing countries, all of which have relatively undeveloped and less robust financial systems, attempt to fix their currencies. This problem is *not* resolved (especially on a sustained basis) by having a currency board despite their obvious advantage in enhancing credibility and providing a "nominal anchor" (Hanke and Schuler 1994; Mishken 1999). At some point the dynamic distortions overwhelm the fixed currency, forcing change.

[70] Over the period 1991 to 1994, Zambia gradually moved to a market-determined exchange rate (Lewis and McPherson 1996). But from mid-1995 onwards, the Bank of Zambia began resisting devaluation as a means of “stabilizing” prices. The pattern of intervention intensified and eventually undermined confidence leading to the re-emergence of the parallel market and widespread currency substitution (Hill and McPherson 1998).

[71] This behavior reconfirms the explanation provided by Robert Bates (1981) of the pressures on officials for agricultural price manipulation. Price controls combined with commodity distribution ensure that the benefits of official support to agriculture are concentrated among potential and actual supporters. Price liberalization confers benefits on supporters and non-supporters alike.

[72] Gray and McPherson (forthcoming) expand on this theme in their monograph *Restarting and Sustaining Growth and Development in Africa.*

[73] Duesenberry, Goldsmith, and McPherson 1999. See also the monograph edited by the same authors with C. Gray *Restarting and Sustaining Growth and Development in Africa* forthcoming.

[74] The reform programs in The Gambia (McPherson and Radelet 1995) and Zambia (Hill and McPherson 1998) provide examples. In The Gambia, President Jawara had been convinced that action was needed to turn the economy around. He would not take the lead. But he was prepared to let his Minister of Finance take the first steps. When these began to have a positive impact, Jawara openly endorsed the reform program. The same applied in Zambia following the elections in 1991. The impetus for economic reform came from finance minister Emmanuel Kasonde and the team of technical economists and “economic ministers” he engaged in promoting reform.

[75] An example (due to Clive Gray) from Senegal illustrates how a leader committed to growth might intervene to help expand NTEs. In 1997, the Senegalese minister of trade, a man with solid private sector credentials, was approached to support a special order of shoes produced in Senegal. A few weeks earlier the French magazine ***Elle*** published a full-page photo of a top fashion model wearing shoes made by a Senegalese artisan. A French importer inquired of the ministry whether Senegal could ship several thousand pairs within a stipulated number of days. Ministry officials made numerous inquiries. They found too many hurdles for such an activity to proceed. Defeated, they had to demur. This experience suggests the following hypothesis: if President Abdou Diouf had issued standing orders to be informed of such queries and regarded as part of his function as President the responsibility for helping mobilize the local effort to respond to such export opportunities, the outcome in Senegal might have been far more constructive. By not having taken such a role in promoting exports (or directing that he be informed of such a need), the president was not aware of the types of problems encountered and whether valuable opportunities for growth were being missed.

[76] *International Financial Statistics* March 1999:692-693; *The Economist* 1st May, 1999:99; *Financial Times* 21st May, 1999 “Sweden”

[77] This point was stressed by Boulding (1958). Policy making, in his view, involves taking current decisions that expand

one's future options (or, at a minimum, do not needlessly constrain them).

[78] The cost has mounted quickly. Estimates provided by the Keinbaum Report in 1993 indicated that ZCCM had a market value of around $750 million. Since 1994 copper production has fallen by an average of 100,000 tonnes. (*The Post* reported on 24 May 1999 even more drastic declines in current production.) The value of that lost production is roughly $750 million. The investment over four years that the Kafue Consortium was to undertake was also $750 million. (The Kafue Consortium had bid unsuccessfully for ZCCM.) Donor aid cancelled due to the delays in action on ZCCM was also around $750 million. ZCCM was reported to be running a deficit of $15 million per month from the downturn in the copper prices. This represents an additional $500 million in debt that the government will have to assume. All of these "losses" have had serious "knock-on" effects which have further lowered output, employment, investment, and savings. Furthermore, the various fudged adopted by the government and Bank of Zambia to "generate" resources have raised the rate of inflation and increased the pressure on the exchange rate. The costs could only be simulated by various empirical "before" and "after" scenarios, but they would have been hundreds of millions of dollars. Thus, it is not too difficult to derive estimates of the costs to Zambia since 1993 of not moving rapidly on the sale of ZCCM on the order of $3 billion or roughly equivalent to Zambia's annual GDP. This "guesstimate" does not include the further dynamic costs that will arise as Anglo American and its future partners continue to delay their decision to act.

[79] "Knowledge for Development" *World Development Report* (World Bank 1998)

[80] This is a major issue in Southern Africa where HIV/AIDS has sharply undercut the supply of skilled personnel. Hoover and McPherson (1999) discuss how AIDS seriously affected efforts to build capacity in Zambia.

[81] The *Long Term Perspectives* study of the World Bank (1990) noted that for economic growth in Africa to accelerate, agricultural output would have to increase at a sustained rate of 4 percent per annum. That datum has been widely repeated (World Bank 1989; *Economist* March 5th, 1994; Badiane and Delgardo 1995; GCA 1999). Based on the sector's historical performance, such an improvement will require the fundamental transformation of African agriculture.

[82] *African Development* Report 1997, Ch. 1; *Agricultural Outlook* April 1999:Table 38

[83] *Agricultural Outlook.* April 1999, Table 17; *African Development Indicators* 1998/99 Table 8.6

[84] In absolute terms, food imports to SSA averaged $5.9 billion from 1990 to 1996. This was equivalent to 9.4 percent of merchandise imports.

[85] Although Bloom and Sachs (1998) emphasize this point in their discussion of the relative difficulties facing African agriculture, the issue has been well understood by agricultural scientists. Indeed, agriculturalists have recognized that whereas agricultural technology is not readily transferable from developed to developing countries, agricultural techniques are. Moreover, they have appreciated that fact that (as a first approximation) a basic difference between temperate and tropical agriculture is that one modifies the environment to better suit plants and animals in the former while it is the reverse in the latter. Finally, as a practical matter, the economic and scientific challenges of modifying plants and animals have been far more profound than in modifying the environment.

[86] There have been some long-standing critiques of the IMF approach (Dell 1980, 1984; enda 1990; Lensink 1996). More recently, the criticisms have focused on IMF handling of the financial turmoil in Asia (Radelet and Sachs 1998, 1998a; Sachs 1998; Stiglitz 1998; Krugman 1998). The IMF response has been ambivalent (Fischer 1998; Lane *et al.*1999). Lester Thurow, by contrast, argues that these views miss the point. Writing in *The Boston Globe* (26 January, 99, p. D4), Thurow noted that blaming the IMF for the turmoil in financial markets does not identify the basic cause. He argued, like Abrahams (1998), Zitner (1998) and Katz (1999), that the key problem has been the melt down in Japan and the unwillingness of the Japanese government to constructively address the financial losses which have caused the economy to deflate for close to a decade.

[87] This was point was made in dramatic fashion at the World Economic Forum's session on Governance in May 1998 in Windhoek, Namibia. The Minister of Finance for South Africa, Trevor Manuel, had been asked to comment on the

requirements for “macroeconomic stability”. His response was that there was little that African policymakers could do to enhance stability in the face of protectionism by the developed world; the threat to financial markets posed by hyper-active financial traders; the market power of first world firms; and the shifting agendas of the international donors. In effect, he argued that African countries were so profoundly affected by external events that they had few viable policy options to stabilize their economies.

[88] Senior policy makers continue to talk about giving African countries special access to rich country markets. This is the essence of the *African Growth and Opportunity Act* presented to the U.S. Congress in 1997. The view was endorsed by the U.S. Secretary to the Treasury, Robert Rubin in remarks to business and national leaders from Africa sponsored by the Corporate Council on Africa in Washington D.C. on 21st April, 1997. In March 1999, President Clinton reaffirmed this commitment adding that African countries would gain special access to debt relief (*Washington Post* 16th March 1999, p.A18). Some African countries see this as a major new direction and have been lobbying for U.S. action (*cf*. Kenya, Government of 1999).

[89] This point is now being made as historians re-examine the record of countries such as Japan that appeared to prosper so extensively under a government-sponsored “industrial policy.” Recent evidence suggests that Japan would have grown even faster and potentially would have fewer difficulties right now had the government been less intrusive (Katz 1999). Notwithstanding Rodrik's (1995) views about "getting [the] interventions right," the record of government efforts to promote growth and development through direct intervention in the economy has been discredited by the economic collapse of the Soviet Union, Eastern Europe, and Africa. Furthermore, China did not begin to grow rapidly until the government ceased intervening in crucial areas such as agriculture.

[90] African leaders see regionalism as a step towards "opening up". For much of the rest of the world, regional arrangements tend to be seen as steps towards protectionism (Bhagwati and Krueger 1995; Bhagwati and Panagariya 1996).

[91] Although Yeats (1994) cast doubt on the usefulness of African trade data, there have been numerous references to the scope of intra-Africa trade. All sources show that it is low (Hardy 1992; *Economist* 5 March 1994; Barry and Beltchika 1996; Stryker, Salinger and Barry 1996; *African Development Indicators* 1998/99:Tables 5.47 to 5.55; Luvanga and Bol 1999:Table 5).

[92] This effort has been given a boost by the need to rehabilitate many of the transport and power systems within Southern Africa. Research on these issues has been undertaken by teams of economists organized through Purdue University and the University of Zimbabwe and funded under the EAGER/Trade Regimes and Growth project.

[93] The model of the "big push", first introduced by Rosenstein-Rodan (1943), has been revived to help explain how increasing returns might provide a stimulus to broad based development (Murphy, Schliefer and Vishny 1989; Sachs and Warner 1997a).

[94] Radelet (1997) has examples.

[95] Sachs (1996) commented that the World Bank has too many ideas and not enough priorities.

[96] Morss (1984) made this point.

[97] Some items were postponed too long. For example, a large amount of research over many years had been undertaken to help strengthen financial supervision in Indonesia. The government delayed implementation.

[98] A similar suggestion appears in UNDP (1994).

[99] An appropriate campaign slogan could be: "The government should rule out ruling over private enterprise."

[100] The model appears in McPherson and Rakovski (1998).

[101] For convenience, I focus on the policy matrix attached to the government's submission to the Consultative Group for Ethiopia (*Ethiopia, Government of 1996:pp.17ff.)*. The same issues arise for any of several policy matrixes prepared since 1992.

[102] OECD (1994) and OECD (1998) describe the reforms that several rich countries attempted and the time taken to implement them.

[103] Devarajan and de Melo 1987, 1991; Gray and Duesenberry 1996

[104] Clement 1995

[105] Data in the *Direction of Trade Statistics Quarterly* December 1998 show that less than 50 percent of the value of trade of Senegal, Côte d'Ivoire and Cameroon is with France and other member of the European Union.

[106] Mishkin 1999

[107] This point is evident in the appendix tables. Growth is low; the spurt in exports has abated; debt remains high; and the deficit persists on the current account deficit of the balance of payments.

[108] O'Connell 1992

[109] Persistent under-valuation of the CFA franc is ruled out by the existence of insupportable levels of external debt.

[110] Advocates of sequencing have been persistent. The idea resurfaced in the context of the Asian financial turmoil. One criticism of the IMF was that it misinterpreted the nature of the problems facing Asia and muddled the time taken and phasing of some of the remedies (Radelet and Sachs 1998). Much of the criticism about the IMF's action in Indonesia hinged on the timing of bank closings, interest rate increases, and budget stringency. Critics argued that, yet again, the IMF had "failed" (Radelet and Sachs 1998a; Sachs 1998). These views have been strongly challenged (Krugman 1998; Fischer 1998).

[111] This assertion gains support in two ways. The first is the "Lucas critique" which relates to the inherent indeterminacy in policy models. Models designed to predict the outcome of policy change are themselves changed by those policies. The second is "Goodhart's Law" which relates to the loss of predictive power of variables that are targets of policy (Goodhart 1989:104). The process of targeting a variable breaks down the original relationship as economic actors change their behavior. When applied to sequencing, these ideas suggest that over time, economic reform will modify the basic structure used to predict the original sequence in ways that cannot *a priori* be anticipated.

[112] Perkins (1994), for example, has identified at least three distinct "Asian" models of growth.

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